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# Modernizing International Trade Law to Support Innovation and Sustainable Development

## Proceedings of the Congress of the United Nations Commission on International Trade Law

Vienna, 4-6 July 2017

Volume 4: Papers presented at the Congress



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## *Session 1 — Qualitative and quantitative benefits in the use of Model Laws*

### *The impact of UNCITRAL on Foreign Direct Investment*<sup>※</sup>

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#### *1. Introduction*

This paper discusses the impact that a number of initiatives by the United Nations Commission on International Trade Law (UNCITRAL) have had on foreign direct investment (FDI). It focuses on initiatives that have strengthened domestic and international legal regimes governing international commercial arbitration (arbitration). Arbitration is relied on by many companies to enforce contracts that cross international borders. For this reason, strengthening the enforcement of these contracts can be expected to lower transaction costs and so promote trade, and foreign direct investment. UNCITRAL's initiatives reviewed in this paper are:

- The *Convention on Recognition and Enforcement of Foreign Arbitral Awards* of 1958 (NY Convention). The NY Convention requires signatories to recognize and enforce awards made in international arbitration proceedings unless certain, relatively restrictive, conditions are met. By facilitating the enforcement of arbitration awards the NY Convention underpins the use of international commercial arbitration. Indeed, large scale use of arbitration is largely traced to the establishment of the NY Convention in the late 1950s (Casella, 1996).
- The Model Law on International Commercial Arbitration of 1985 (Model Law on Arbitration). According to UNCITRAL the Model Law on Arbitration is designed to help states to strengthen their arbitration laws. The Model Law on Arbitration covers arbitral process all the way from the agreement to enforcement of the award. It includes the composition and jurisdiction of the arbitral tribunal, and court interventions in the arbitral process (UNCITRAL, 2016a). By adopting the Model Law on Arbitration countries should improve the reliability and predictability of using arbitration to resolve contractual disputes.
- The Model Law on International Commercial Conciliation of 2002 (Model Law on Conciliation) provides uniform rules with respect to the conciliation process with the aim of ensuring greater predictability and certainty in its use. "The Model Law addresses the procedural aspects of conciliation, including appointment of conciliators, commencement and termination of conciliation, conduct of the conciliation, communication between the conciliator and other parties, confidentiality and admissibility of evidence in other proceedings as well as post-conciliation issues, such as the conciliator acting as arbitrator and enforceability of settlement agreements" (UNCITRAL, 2016b). An important benefit of the Model Law on Conciliation is that it should reduce the expected cost of using arbitration by decreasing the need for arbitration proceedings.

This paper evaluates these initiatives in three parts. Section 2 describes the impact that UNCITRAL's initiatives can be expected to have; section 3 discusses the results of preliminary empirical analysis on the role that UNCITRAL's initiatives have had. 4 concludes with some implications for policy.

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<sup>※</sup> The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors. They do not represent the views of the World Bank and its affiliated organizations or those of the executive directors of the World Bank or the governments they represent. Jordi Paniagua gratefully acknowledges the financial support from Spain's Ministry of Economy and Competitiveness (project ECO2015-68057-R).

## 2. *Expected Economic Impact of UNCITRAL's initiatives*

The importance of arbitration arises from the difficulties firms face when they use foreign domestic courts to enforce cross border contracts. Firms can be unfamiliar with foreign laws and legal processes. Furthermore, surveys suggest that firms often have concerns about the impartiality, length of proceedings, expertise and levels of corruption in foreign courts (PwC, 2013). All these factors lead firms to be wary of relying on foreign jurisdictions to enforce contracts.

Many of the concerns that firms have with relying on foreign domestic are mitigated by arbitration. Surveys (PWC, 2013) find that firms are attracted to arbitration due to the expertise and neutrality of the decision maker, confidentiality of the proceedings a lack of familiarity with the courts and laws in foreign countries, and enforceability. When firms use arbitration they are able to decide the process used for selecting the arbitrators, the procedures under which the arbitration will be conducted, and the law under which any disputes will be adjudicated. The majority of contracts reference English or New York State law. These jurisdictions have large bodies of precedent that provide guidance on the likely results of arbitration proceedings in the wide range of circumstances that can lead to a dispute (Landes and Posner, 1976). Finally, due to the widespread adoption of the NY Convention it is often easier to enforce international commercial arbitral awards than awards made by foreign domestic courts.

The benefits of arbitration will be greatest for relationship specific investments. These are defined as investments that have far less value outside of the initial relationship. A concrete example is an investment in a coal mine that will be located next to its only customer, a power station. A firm would typically only invest in the coal mine if it had entered into a contract with the power plant outlining the amount and price of coal that the power plant will purchase. If the mine is then built, but the power station breaches the contract by stopping payments the value of the investment in the coal mine would be greatly reduced. For this reason, a mining company would be wary of making an investment in the coal mine unless they were confident that they could enforce the contract with the power plant. As this example suggests relationship specific investments often arise in infrastructure. Other examples include large construction projects where a failure to pay for the project would lead to losses for the construction firm, the provision of finance where a failure by a borrower (say) to pay back the loan leads to losses, imports where the importer cannot be sure of the quality of the product being purchased, and projects that have an intellectual property component where the client can use the intellectual property but refuse to pay for it.

Difficulties enforcing contracts can be expected to lead to less relation specific investments. Consistent with this, Nunn (2007) finds that a country's ability to enforce written contracts is an important determinant of its comparative advantage. This result is based on the insight that improved contract enforcement leads to higher relationship-specific investments which leads to the expansion of sectors in which these investments are particularly important Nunn (2007). Another example is (Berkowitz et al, 1996) who finds that adopting the NY Convention is associated with greater export of goods whose quality is difficult to evaluate at point of delivery.

While there are often benefits from using arbitration rather than the domestic courts, arbitration comes at a cost. It is estimated that in many countries the cost of an arbitration case is ten times, or more, expensive than the cost of a comparable case in a domestic court (Myburgh & Paniagua, 2016). One contributor to these higher costs is that unlike in a domestic court whose services are typically provided at low or no cost, the parties to an arbitration need to pay for the arbitrators as well as various administrative expenses. This can be a substantial proportion of the damages sought, especially for smaller claims. The Paris based International Chamber of Commerce reports that its costs make up a substantial proportion of small claims. It estimates that litigants will be charged 35% of a 100,000 Euro claim or 35,000 Euro, 13% of a million Euro claim or 130,000 Euro, and 4% of a 10 million Euro claim or 400,000 Euro. Due to the high cost of arbitration commentators suggest that parties use the domestic courts for disputes over smaller amounts (Casella, 1996).<sup>1</sup>

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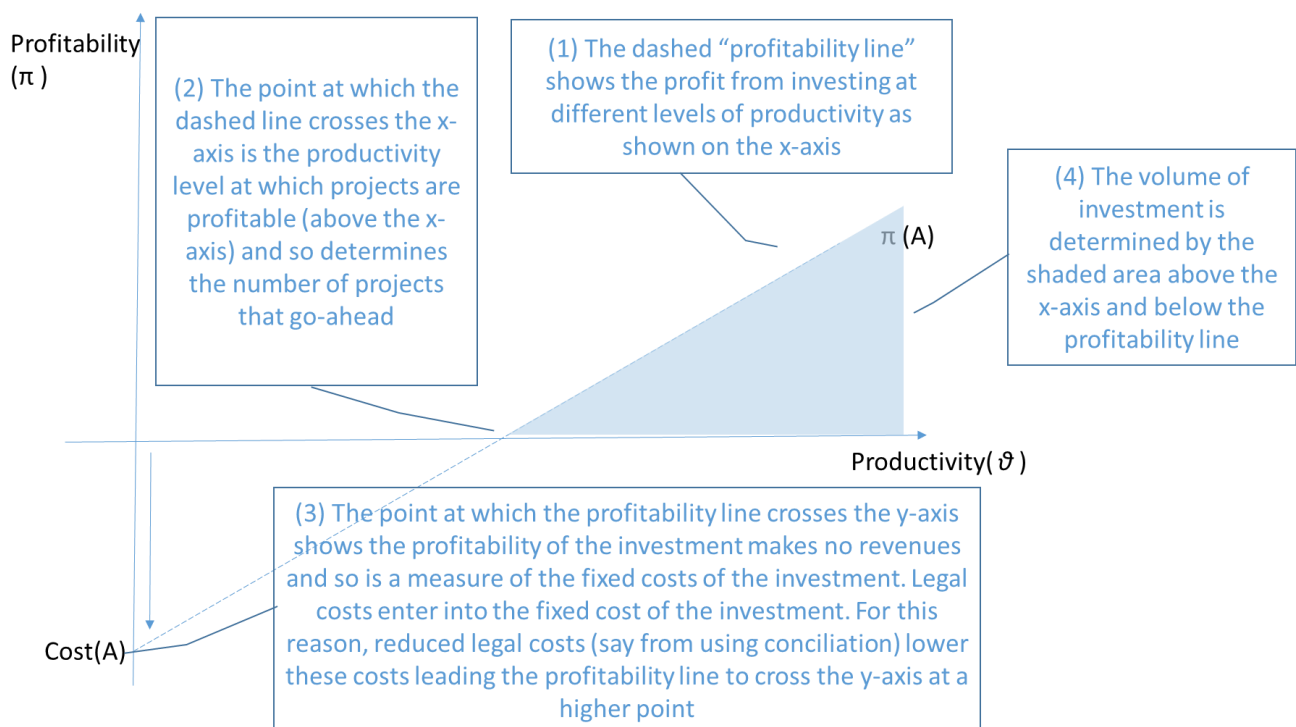
<sup>1</sup> This discussion is focused on arbitration around investments. For disputes over the delivery of goods the cost of arbitration can be relatively low at a few thousand dollars.

An important way to lower the cost of using arbitration is to promote the use of mediation and conciliation. Increasing the use of mediation and conciliation can reduce the number of disputes that enter into arbitration proceedings. Due to the high costs of arbitration proceedings this can significantly reduce the cost and time of disputes (Love, 2011). For example, a study found that in Argentina a mediation costs one sixth of an arbitration (Jorquiera and Alvarez, 2005). This suggests that even a small increase in disputes resolved through mediation and conciliation can substantially reduce the expected cost of using arbitration to resolve disputes arising from a contract.

### 2.1. A simple model of the impact of UNCITRAL's initiatives

To understand the effect of the improvements in arbitration that UNCITRAL brings it is useful to consider a simple model based on Meltiz (2003). This model is illustrated in Figure 1. The model assumes that there is a range of prospective investment projects with different levels of productivity  $P(\theta)$ . Each MNE receives a signal on how productive its investment it will be, and then it decides whether to invest, and how much to invest if it does. The profitability of investing at different levels of productivity is shown by the upward sloping "profitability line". The point at which this line crosses the x-axis is the productivity threshold above which there is a positive return and so firms invest. All projects to the right of that threshold are undertaken. The distance from the right hand side of the graph to this crossing point determines how many projects will be undertaken. The amount invested in each project is determined by how profitable it is. More is invested in projects that are more profitable (i.e. further above the x-axis). Total investment is a function of the area below the profitability line but above the x-axis (as shown by the shaded area in Figure 1). The greater this area the greater the total volume of FDI.

**Figure 1: Description of the model**

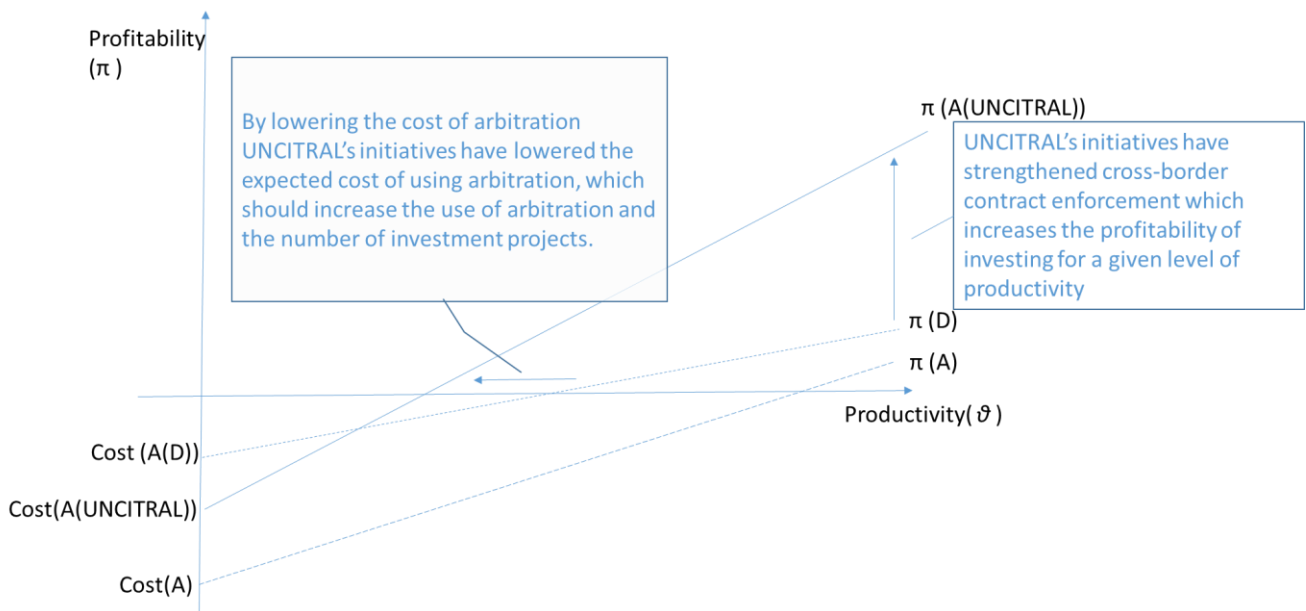


The model described by Figure 1 allows us to review firms' decisions to use different forms of dispute resolution, and also the impact that this has on the volume of investments, and the number of investments made. When firms to use a particular form of dispute resolution, such as the domestic courts, this has implications for their profitability and fixed costs (Myburgh and Paniagua, 2016). By comparing the profitability under three different scenarios we can investigate what our priors suggest should be the impact of UNCITRAL's initiatives on investment. In particular we review three scenarios:



1. **Scenario 1: Domestic courts.** Here firms can only use foreign domestic courts to enforce contracts. The profitability ( $\pi(D)$ ) of the resulting investments at different levels of productivity ( $P(\theta)$ ) is shown by the dotted line. The result is relatively poor contract enforcement and so few investment projects as the profitability line cross the x-axis far to the right, and relatively low levels of investment as poor contract enforcement depresses profitability (the profitability line is not far above the x-axis).
2. **Scenario 2: Arbitration with poor legal protections.** Under this scenario the profitability of using arbitration is shown by the dotted line with longer dashes ( $\pi(A)$ ). This line falls below ( $\pi(D)$ ) across projects with different levels of productivity. This assumes that relying on arbitration is less profitable than using the domestic courts because the benefits of using arbitration do not outweigh the higher costs. This is consistent with the view that absent the protections provided by the NY Convention, the Model Law on Arbitration and similar domestic laws, arbitration would be seldom used. This is in line with the historical experience that there was little use of arbitration prior to the NY Convention (Casella, 1996).
3. **Scenario 3: Arbitration with strong legal protections including those provided by UNCITRAL.** UNCITRAL's initiatives have two effects. The first is to make arbitration a more effective form of contract enforcement. As a result, the line that shows the profitability line from investing using arbitration ( $\pi(A(\text{UNCITRAL}))$ ) is steeper than the profitability line when domestic courts are used ( $\pi(D)$ ). It is steeper because investments are more profitable at every level of productivity. A steeper line can be expected to increase the size of investments, and volume of investments. The second effect is to lower the expected cost of using arbitration through the Model Law on Conciliation. This increases the number of projects for which it is profitable to use arbitration which in turn can be expected to increase the number of investment projects.

**Figure 2: Firms profitability from arbitration and domestic courts**



### *2.1. Implications of the analysis*

Overall the analysis in this section predicts that UNCITRAL's initiatives should promote FDI in sectors where investments are relationship specific, and that in particular:

1. The NY Convention, the Model Law on Arbitration and to a lesser extent the Model Law on Conciliation should increase the volume of investment.
2. The Model Law on Conciliation and to a lesser extent the Model Law on Arbitration and the NY Convention should increase the number of investment projects.

The next section reviews the results of a number of preliminary empirical exercises that evaluate these predictions.

### *3. Empirical analysis of UNCITRAL's initiatives*

This section conducts a preliminary analysis of the impact of UNCITRAL's initiatives on different sectors and types of activity. Although the results of this analysis are inherently tentative, we do find some indications that UNCITRAL's initiatives are associated with an increase in FDI. The research discusses previous research on the NY Convention by Myburgh and Paniagua (2016), it then extends this analysis to discuss the impact of UNCITRAL's initiatives on different types of investments, and investments in different sectors.

Myburgh and Paniagua (2016) find that the NY Convention is associated with large increases in FDI. The paper finds that there is a far larger increase in the volume of investments, than in the number of investment projects. This result is consistent with the discussion in Section 2 which found that the high cost of arbitration should limit its usefulness to smaller projects, and so the NY Convention would largely affect the volume of investment rather than the number of investment projects. We extend this result in the Appendix and find that as expected adoption of the Model Law on Conciliation is associated with an increase in the number of projects.

As discussed in Section 2 one would expect UNCITRAL's initiatives to be more important for investment activities that are more likely to relationship specific. To test this hypothesis we analyse the association between UNCITRAL's initiatives, and aggregate FDI on a cross-section of 87 countries across a number of investment activities. After controlling for GDP the regression explains around 70% of variation in aggregate FDI. As shown in Figure 3 the results suggest that the NY Convention and UNCITRAL's Model Law on Arbitration are associated with higher volumes of FDI in a number of activities. Notably this includes construction, business services, design and ICT. The activities where UNCITRAL's initiatives are positively associated with higher volumes of FDI are arguably the activities that are more likely to be relationship specific than those activities such as customer care where UNCITRAL's initiatives are not positively associated with higher volumes of FDI. These results are consistent with the proposition that UNCITRAL's initiatives have promoted FDI (for more detail on some of the limitations of the analysis see footnote 2 and the Appendix).<sup>2</sup>

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<sup>2</sup> As discussed in more detail in the Appendix there are limitations to an analysis of this kind. In particular, factors other than UNCITRAL's initiatives are likely to be promoting FDI and so one cannot definitively conclude from this analysis alone that UNCITRAL's initiatives have caused the increase in FDI. The limitations in data mean that one cannot conclude that UNCITRAL's initiatives are not having an impact in the sectors because there is no positive statistical relationship shown. For example, it may be that the Model Law on Conciliation does promote FDI in more sectors. However, too few countries have adopted it, and we have relatively little data by activity. This suggests that even though a positive relationship may exist our analysis may not have found a statistically significant relationship.

**Figure 3: Association between FDI and UNCITRAL's initiatives, a (+) shows a significant statistical relationship**

Activity type	Activity	Adopted NY Convention	Adopted UNCITRAL Model Law on Arbitration	Adopted UNCITRAL Model Law on Conciliation
Customer	Business services	+	+	+
	Sales & Marketing	+		
	Customer care			
	Tech support			
	Shared services			
Complex	Headquarters			
	Design	+		
	ICT	+	+	
	RD			
	Education			
High Fixed costs	Maintenance			
	Extraction			
	Manufacturing			
	Logistics		+	
	Construction	+	+	

#### 4. Concluding Remarks

This paper has found that UNCITRAL's initiatives to strengthen the domestic and international legal regimes for arbitration have promoted foreign direct investment (FDI). The paper suggests that UNCITRAL's initiatives have promoted relationship specific investments. Countries that adopt the NY Convention and UNCITRAL's Model Laws on Arbitration and Conciliation tend to experience higher levels of investments in sectors such as construction and activities such as ICT.

#### Appendix I

We conduct a series of statistical exercises to evaluate the importance of UNCITRAL's initiatives for FDI. These exercises aim to show where UNCITRAL's initiatives are associated with more FDI and the nature of this association. They also provide a tentative indication of the impact that these initiatives may be having on FDI. Our analysis has a number of limitations which suggest that results should only be considered tentative. An important limitation is that we have not been able to model the factors that lead countries to adopt the Model Laws, or the NY Convention. This is a particular limitation in the case of the Model Law on Arbitration. It appears that jurisdictions such as England or Hong Kong with established arbitration regimes have not adopted the Model Law on Arbitration. This phenomenon suggests that adoption of the Model Law will not be monotonically associated with a stronger arbitration regime. This will tend to attenuate any relationship between adoption of the Model Law and FDI and so could lead to fewer statistically significant results. Consistent with this we find fewer statistically significant results for the adoption of the Model Law on Arbitration than we expected. A number of important variables used in the analysis are shown in Table 1.

**Table 1: Variables dictionary**

Variable	Description	Source
LFDI	Log of aggregate incoming greenfield FDI in 2012	FDI Markets
LGDP	Log of GDP	World Bank data
NYC	Is the country a member of the NY Convention?	NY Convention
UNCITRAL	Had the country adopted the Model Law on Arbitration by 2010?	UNCITRAL
CONCIL	Had the country adopted the Model Law on Conciliation by 2010?	UNCITRAL

We conduct a sector analysis to examine in depth effects that might be hidden on an aggregate level. Rather than focusing on sectors, we study the individual's investment project activity. Firms' activity reveal more information than aggregate sectoral data. For example, a highly complex chemical project might be masked in the agricultural sector. We have identified three groups of activities on which we expect a different impact of arbitration: high fixed costs, complex and customer activities.

The estimations related to activities with high fixed costs are reported in Table 2. These activities are maintenance, extraction, manufacturing, logistics and construction. Contrarily as expected, arbitration has no significant association with most activities with high fixed costs. Arbitration, both UNCITRAL and NY Convention, has a positive and significant association with FDI only in construction.

**Table 2: High Fixed Cost Activities**

	(1) Maintenance	(2) Extraction	(3) Recycling	(4) Manufacturing	(5) Logistics	(6) Construction
LGDP	0.865*** (0.08)	0.514*** (0.18)	0.908*** (0.10)	0.901*** (0.09)	1.078*** (0.10)	1.082*** (0.12)
NYC	0.122 (0.64)	0.403 (1.39)	-0.424 (0.75)	0.610 (0.69)	1.093 (0.77)	2.482*** (0.92)
UNCITRAL	0.144 (0.34)	0.263 (0.74)	0.104 (0.40)	0.020 (0.37)	0.734* (0.41)	1.101** (0.50)
CONCIL	-0.032 (0.56)	-0.128 (1.21)	-0.125 (0.65)	-0.326 (0.60)	0.104 (0.67)	-0.094 (0.81)
Observations	87	87	87	87	87	87
R <sup>2</sup>	0.601	0.110	0.531	0.589	0.654	0.620

Standard errors in parentheses

\* p < 0.10, \*\* p < 0.05, \*\*\* p < 0.01

Complex activities (Headquarters, Design, ICT, RD and Education) are reported in Table 3. The picture is different from high fixed cost activities. Arbitration has a positive association in most of them (except for HQ, which might not involve complex activities). NY Convention is positive and significant for Design and ICT and UNCITRAL membership as well for ICT.

**Table 3: Complex Activities**

	(1) Headquarters	(2) Design	(3) ICT	(4) RD	(5) Education
LGDP	1.136*** (0.10)	1.201*** (0.09)	0.707*** (0.12)	1.161*** (0.10)	0.857*** (0.08)
NYC	0.136 (0.77)	1.230* (0.70)	2.557*** (0.95)	0.916 (0.77)	-0.574 (0.58)
UNCITRAL	0.261 (0.41)	0.369 (0.38)	1.133** (0.51)	-0.180 (0.41)	0.260 (0.31)
CONCIL	-0.133 (0.67)	-0.291 (0.61)	0.408 (0.83)	0.343 (0.67)	-0.066 (0.50)
Observations	87	87	87	87	87
R <sup>2</sup>	0.642	0.724	0.472	0.656	0.633

Robust standard errors in parentheses

\* p &lt; 0.10, \*\* p &lt; 0.05, \*\*\* p &lt; 0.01

Business Services, Sales and Marketing, Customer care, Tech support and Shared Services are the customer related activities. The estimation results are reported in Table 4. Again, although we observe certain heterogeneity, most of customer related activities are found to have a positive impact from arbitration. Particularly Business Services is positively associated with both NY Convention, and adoption of the Model Laws on Arbitration and Conciliation.

**Table 4 Customer Activities**

	(1) Business Services	(2) Sales Marketing	(3) Customer Care	(4) Tech Support	(5) Shared Services
LGDP	0.688** (0.06)	0.787*** (0.06)	0.835*** (0.08)	0.732*** (0.10)	0.660*** (0.11)
NYC	0.932** (0.42)	1.407*** (0.44)	-0.069 (0.63)	-0.369 (0.76)	0.500 (0.84)
UNCITRAL	0.616*** (0.23)	0.305 (0.23)	0.439 (0.34)	0.335 (0.41)	0.326 (0.45)
CONCIL	0.748** (0.37)	-0.170 (0.38)	0.541 (0.55)	0.310 (0.66)	0.167 (0.73)
Observations	87	87	87	87	87
R <sup>2</sup>	0.729	0.764	0.604	0.434	0.360

Robust standard errors in parentheses

\* p &lt; 0.10, \*\* p &lt; 0.05, \*\*\* p &lt; 0.01

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## *I. Introduction*

UNCITRAL's mission is to promote the progressive harmonization and unification of the law of international trade.<sup>1</sup> It has been entrusted with this task because divergences in national trade laws have been recognized as impediments to the development of world trade.<sup>2</sup> World trade, in turn, has been considered an important factor in the promotion of friendly relations between States and, consequently, the maintenance of peace and security.<sup>3</sup> Harmonization has traditionally gone hand in hand with modernization as anachronistic trade law will never facilitate international trade. Modernization also sets the stage for innovation<sup>4</sup> and sustainable development.

In its 50 years of existence, UNCITRAL has significantly contributed to the harmonization and modernization of various areas of international trade law. Over five decades UNCITRAL has created texts in areas as diverse as international commercial arbitration, procurement, insolvency, online dispute resolution, the international sale of goods and security interests.

Among UNCITRAL's texts are several whose dissemination is truly global. Examples of groundbreaking pieces that harmonized and modernized international trade law include the New York Convention (NYC, with 157 Contracting States<sup>5</sup> at the time of writing) and the UNCITRAL Model Law on International Commercial Arbitration (ICA-ML, adopted in 76 States and a total of 107 jurisdictions<sup>6</sup>).<sup>7</sup> These texts have been so successful that they have indeed become cornerstones in their field, even having an impact on jurisdictions that did not adopt them.

Other texts created by UNCITRAL have been blessed with less success. The UN Convention on International Bills of Exchange and International Promissory Notes, for example, has only managed to attract five Parties in almost 30 years, despite requiring ten in order to actually enter into force.<sup>8</sup> The UN Convention on the Liability of Operators of Transport Terminals in International Trade is likewise still waiting to enter into force with the receipt of the fifth action it requires since it has not been able to amass more than four instruments of ratification, accession, approval, acceptance or succession since 1991.<sup>9</sup>

Why do some harmonizing texts virtually reshape the landscape of international trade law while others turn out to have no effect on harmonization and modernization at all? This question is vital for a law-making institution like UNCITRAL, even more so since its resources (and the resources of its Member States) are limited<sup>10</sup> and texts that ultimately remain little more than drafts do not advance UNCITRAL's mission to promote harmonization of international trade law.

Success has many faces and the search for success factors does not yield simple answers. The need for reform and the substantive quality of proposed rules are obvious factors for success. Other factors for the

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<sup>1</sup> General Assembly resolution 2205 (XXI), sub I.

<sup>2</sup> General Assembly resolution 2205 (XXI), fifth recital.

<sup>3</sup> General Assembly resolution 2205 (XXI), third recital.

<sup>4</sup> For an example, see Cohen, *Unif. L. Rev.* 325, 327 (2010); more generally Basedow, *RabelsZ* 81 (2017), 1, 9.

<sup>5</sup> See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html) (last visited Oct. 6, 2017).

<sup>6</sup> See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/1985Model\\_arbitration\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration_status.html) (last visited Oct. 6, 2017).

<sup>7</sup> Cf. Kronke, *JZ* 2001, 1149, 1150: two of six "true success stories of global private law harmonization."

<sup>8</sup> See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/payments/1988Convention\\_bills\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1988Convention_bills_status.html) (last visited Oct. 6, 2017).

<sup>9</sup> See [http://www.uncitral.org/uncitral/en/uncitral\\_texts/transport\\_goods/1991Convention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/transport_goods/1991Convention_status.html) (last visited Oct. 6, 2017).

<sup>10</sup> For that aspect, see *Knieper*, in: *Liber amicorum Knežević*, 2016, pp. 654, 668 *et seq.*

success of a legal text are less obvious but no less decisive. A notable inclusion in these less obvious factors is the proper choice of instrument, i.e. the technique employed to harmonize and modernize the law.

This paper attempts to shed light on one of these instruments that has been neglected almost completely thus far, namely the model law. Before going on to discuss the success factors for model laws (below IV), this paper will elaborate on where model laws are located in the system of available instruments for harmonization (below II) and on how they operate (below III).

## II. *The Model Law Within the System of Instruments*

Traditionally, harmonization and modernization was achieved through conventions. While conventions are still an important instrument for harmonizing and modernizing international trade law, alternative harmonization instruments have entered the stage over the last few decades and have been receiving more and more attention. Before turning to one of these instruments (the model law) in detail, it is worthwhile to provide a quick overview of the available instruments. These instruments can be divided into three classes: legislative, contractual and explanatory instruments.<sup>11</sup>

### I. *Legislative Instruments*

Legislative instruments either have force of law (conventions) or are addressed to legislatures to enact national laws accordingly (model laws, legislative guides).

#### (a) *Conventions*

Conventions are concluded between States, usually at a diplomatic conference or in the United Nations General Assembly,<sup>12</sup> and require States to express their consent to be bound by the convention (Art. 11 *et seq.* of the 1969 Vienna Convention on the Law of Treaties). If it is self-executing, a convention creates uniform law that directly governs the transactions that fall within its scope of application.<sup>13</sup> Technically, this method of unification results in the highest degree of harmonization that can be achieved.<sup>14</sup>

#### (b) *Model Laws*

The model law is an alternative legislative instrument. It is a “best practice law” which is suggested for adoption, i.e. for incorporation into the national laws of the States.<sup>15</sup> Upon adoption, the model law provisions become part of the State’s domestic law.

While a convention can generally only be ratified in its entirety or not at all,<sup>16</sup> the States are free to adopt a model law in parts or with modifications.<sup>17</sup> A model law can, however, only achieve its harmonizing effect to the extent that its provisions are adopted by the States. It therefore does not come as a surprise that UNCITRAL regularly encourages States to adopt its model laws in full.<sup>18</sup>

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<sup>11</sup> A Guide to UNCITRAL, 2013, paras 32 *et seq.* (available at <http://www.uncitral.org/pdf/english/texts/general/12-57491-Guide-to-UNCITRAL-e.pdf>, last visited Oct. 6, 2017).

<sup>12</sup> A Guide to UNCITRAL (fn. 11), para. 39; UNCITRAL Secretariat, A/CN.9/204, para. 11.

<sup>13</sup> UNCITRAL Secretary-General, A/CN.9/203, para. 117.

<sup>14</sup> A Guide to UNCITRAL (fn. 11), para. 35.

<sup>15</sup> A Guide to UNCITRAL (fn. 11), para. 37; *Boele-Woelki*, Recueil des Cours 271 (2009), 2010, pp. 271, 327 para. 54; *Cohen*, 36 Brook. J. Int’l L. 567, 582 (2011).

<sup>16</sup> *Boele-Woelki* (fn. 15), p. 338 para. 68 (“all boils down to the motto: ‘Take it or leave it!’”).

<sup>17</sup> A Guide to UNCITRAL (fn. 11), para. 38; *Herrmann*, Unif. L. Rev. 483, 484 *et seq.* (1998); *Herrmann*, Bus. L. Int’l 249, 252 (2001).

<sup>18</sup> A Guide to UNCITRAL (fn. 11), para. 38; UNCITRAL Secretary-General, A/CN.9/207, para. 26; *Herrmann*, Unif. L. Rev. 483, 493 (1998); see also *Boele-Woelki* (fn. 15), p. 328 para. 54.



### (c) *Legislative Guides*

The softest of the legislative instruments is the legislative guide. These guides restrict themselves to setting out policy considerations for the benefit of national legislatures.<sup>19</sup> This allows for utmost flexibility when it comes to the transformation into national law.

### 2. *Contractual Instruments*

While legislative instruments address legislatures, the addressees of contractual instruments are the parties to a contract, i.e. businesses. Examples of contractual instruments include the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules. Since contractual instruments address businesses, it is hardly surprising that such instruments have also been developed by private organizations which do not have the standing to create legislative instruments.<sup>20</sup> Prominent examples include the International Chamber of Commerce (ICC), which provides model contracts and model clauses like the Incoterms, as well as the International Federation of Consulting Engineers (FIDIC) with its standard contracts.

Since contractual instruments have different addressees than legislative instruments, they function in a fundamentally different way. On the one hand, contractual instruments are limited in their potential scope of application. Contracts can only operate within the framework of the legal systems to which they are subordinated. Standard contracts will inevitably fail where the governing law's mandatory provisions do not leave room for party-autonomous stipulations. Contractual instruments can also never entail mandatory provisions that limit the parties' contractual freedom.<sup>21</sup> As a result, only legislative instruments are available where the legal area that is in need of harmonization entails issues that are not to be left up to the parties.

On the other hand, being located on the contractual level allows contractual instruments to operate largely independently of the applicable legislative framework.<sup>22</sup> Since mandatory statutory rules only limit the parties' contractual freedom in exceptional situations, standard contracts may establish a *de facto* uniform legal framework that works even in legal environments that are neither harmonized nor modernized. Contractual instruments moreover have the advantage of greater adaptability: standard contracts can be adapted to changed circumstances more easily than laws that need to undergo an elaborate revision process.

### 3. *Explanatory Instruments*

The last class of instruments for the harmonization and modernization of law are explanatory instruments.<sup>23</sup> Contrary to the other two classes of instruments, explanatory instruments operate as guidelines or general advice but do not result in standardized legal texts.

In light of their limited effect on harmonization, explanatory instruments will usually only be considered where stronger instruments fail for specific reasons. The UNCITRAL Recommendation on the Interpretation of Art. II(2) and VII(1) of the New York Convention<sup>24</sup> (which undertook the modernization of the 1958 New York Convention's in-writing requirement) provides for a characteristic example: in terms of the number of its Contracting Parties, the New York Convention has been considered too successful to be amended or supplemented by another convention. Amending the Convention was considered likely to

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<sup>19</sup> A Guide to UNCITRAL (fn. 11), paras 43 *et seq.*

<sup>20</sup> *Boele-Woelki* (fn. 15), p. 341 para. 72.

<sup>21</sup> Cf. UNCITRAL Secretary-General, A/CN.9/203, para. 115; *Herrmann*, *Unif. L. Rev.* 483, 484 (1998).

<sup>22</sup> On harmonization through standard contracts, see, e.g., the contributions of *Collins, Ackermann* and *Möslein*, in: Eidenmüller, *Regulatory Competition in Contract Law and Dispute Resolution*, 2013.

<sup>23</sup> A Guide to UNCITRAL (fn. 11), paras 19 *et seq.*

<sup>24</sup> Recommendation regarding the interpretation of article II, paragraph 2, and article VII, paragraph 1, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done in New York, 10 June 1958, adopted by the United Nations Commission on International Trade Law on 7 July 2006 at its thirty-ninth session, Issued in Official Records of the General Assembly, Sixty-first Session, Supplement No. 17 (A/61/17), annex II.

exacerbate the existing lack of harmony since adoption of a binding instrument would have taken several years. In light of these circumstances, an interpretative declaration has been identified as the proper instrument for modernizing the New York Convention.<sup>25</sup>

### *III. Implementation and Application Issues for Model Laws*

Before the success factors for model laws can be discussed (below IV), it is worthwhile to take a closer look at how this instrument functions.

#### *1. Methods of Model Law Adoption*

Model laws, unlike conventions, can neither be acceded to nor can they assume force of law. Indeed, model laws are ultimately nothing more than templates for domestic legislation to be enacted in their image. In most cases, model laws are translated into the enacting jurisdiction's official language (if need be) and their text goes through the usual legislative procedure in the same way as any other bill.

UNCITRAL's model laws are designed to be fully incorporated into bodies of statutory law. They are drafted as fully-fledged statutes while consistently using placeholders like "this State" (e.g. Art. 1 ICA-ML) or gaps as in Art. 6 ICA-ML ("The functions referred to in articles 11(3), 11(4), 13(3), 14, 16(3) and 34(2) shall be performed by ... [Each State enacting this model law specifies the court, courts or, where referred to therein, other authority competent to perform these functions.]"). If the model law is not enacted as a standalone law but as part of a code, some issues may be better treated in another part of the code.<sup>26</sup>

Model laws can, however, also be incorporated by reference. Art. 16(1) of the Australian International Arbitration Act, for example, provides that "[s]ubject to this Part, the Model Law has the force of law in Australia." If this approach is selected, placeholders need to be defined ("The following courts are taken to have been specified in Article 6 of the Model Law ...", Art. 18(3) of the Australian International Arbitration Act) and gaps filled in the referencing law: "'this State' means Australia (including the external Territories)" (Art. 16(1) of the Australian International Arbitration Act). Legally, both methods of adoption are equivalent.

#### *2. Unified Interpretation and Application*

Model laws, unlike conventions, do not remain self-contained bodies of autonomous law but become fully integrated parts of the national legal system upon adoption. This specific feature gives rise to both legal and factual difficulties in achieving harmonization and modernization.

##### *(a) Legal Difficulties*

The legal difficulties that can arise in relation to the unified interpretation and application of model-law-based provisions can be explained best in comparison to conventions. Conventions can create autonomous law, the interpretation and application of which should not depend on which court interprets and applies it.<sup>27</sup> Autonomous law is not subjected to domestic rules of interpretation. The criteria for interpretation are rather to be derived only from the law itself. In practice there is always the possibility that

<sup>25</sup> For a summary of this discussion, see *Wolff*, in: *Wolff, New York Convention, Commentary*, 2012, Art. II paras 18 *et seq.*

<sup>26</sup> *Estrella Faria*, Legal Harmonization through Model Laws: The Experience of the United Nations Commission on International Trade Law (UNCITRAL), paper delivered at the ALRAESA Conference, March 15-17, 2005, South Africa, p. 20 (available at [http://www.justice.gov.za/alraesa/conferences/2005sa/papers/s5\\_faria2.pdf](http://www.justice.gov.za/alraesa/conferences/2005sa/papers/s5_faria2.pdf), last visited Oct. 6, 2017).

<sup>27</sup> *Kropholler*, *Internationales Einheitsrecht*, 1975, pp. 235 *et seq.*, 240 *et seq.*

different courts will not reach the same results when applying the same rules to the same facts,<sup>28</sup> but in theory they should.

Model law provisions, conversely, become part of national law once they are adopted.<sup>29</sup> Although they can all be traced back to the same model, similar provisions under several different national laws cannot be interpreted uniformly due to a lack of an autonomous legal text.<sup>30</sup> The standard for interpretation for model-law-based national provisions is therefore to be determined under the national law of the State that has adopted the model law. This finding is crucial from a harmonization perspective since only the way in which the law is applied is relevant for harmonization at the end of the day; merely having uniformity of wording is useless.<sup>31</sup>

Applying a domestic standard of interpretation when interpreting model-law-based provisions does not, however, necessarily result in the application of exactly the same methods of interpretation that apply to any other domestic law of that State. Whether or not the international origin of model-law-based provisions is to be taken into account depends solely on the rules of interpretation of the respective State.

In fact, all of the traditional means of interpretation allow for the consideration of the model-law-based provisions' origin:<sup>32</sup> when exploring the meaning of a term, specifically its legal meaning, the literal interpretation may treat the model-law-based provisions as a self-contained body of law, the terminology of which is uncoupled from the remaining legal order. The historical interpretation may include the model law's drafting history. The systematic interpretation may again treat the model-law-based provisions as a self-contained body of law and construe it from within itself. The teleological interpretation may take the purpose of implementing harmonized law into account and therefore reference the purpose attached to the respective provision of the model law. A comparative interpretation (in the manner in which it is recognized as a means for interpretation of uniform law) may call for consideration of foreign case law and legal writing on model-law-based provisions (or on the model law itself) and a comparative examination of model-law-based provisions with non-unified national law that can contribute to identifying a suitable understanding of the model-law-based provisions.

Taking into account the origin of model-law-based provisions can promote unified interpretation — provided that the rules of interpretation in the State adopting the model law so permit. To facilitate such permission, it is advisable to include provisions like Art. 2 A(1) ICA-ML (“In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith.”) in model laws.<sup>33</sup> Even in jurisdictions in which such provision was not needed, its presence serves to remind judges and other users of the special traits of rules that only appear to be an indistinguishable part of the national body of law at first glance.

The States are, however, free to screen out such provisions when adopting a model law and to decouple their national law from its model law background. This approach may be taken by States that intend to implement a modern and well-drafted law while keeping full control over its interpretation. However, cutting the model-law-based provisions off from their international origin comes at the price of cropping their harmonizing and trade-promoting effect. As this outcome will usually not be in the State's best interest, this step should not be taken without careful consideration.

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<sup>28</sup> *Boele-Woelki* (fn. 15), p. 299 para. 16.

<sup>29</sup> *Linhart*, *Internationales Einheitsrecht und einheitliche Auslegung*, 2005, p. 253.

<sup>30</sup> *Wolff*, *AYIA* 2014, 51, 56 *et seq.*; dissenting *Bachand*, in: *Bachand/Gélinas*, *The UNCITRAL Model Law after 25 Years: Global Perspectives on International Commercial Arbitration*, 2013, pp. 242 *et seq.*

<sup>31</sup> *Bachand* (fn. 30), pp. 231 *et seq.*; *Gebauer*, *Unif. L. Rev.* 683, 691 (2000); see also *Schmitthoff*, *17 Int'l & Comp. L.Q.* 551, 566 *et seq.* (1968).

<sup>32</sup> For details, see *Wolff*, *AYIA* 2014, 51, 63 *et seq.*

<sup>33</sup> For details, see *Wolff*, *AYIA* 2014, 51, 69 *et seq.*

### *(b) Factual Difficulties*

Even if the legal tools which allow for unified interpretation are available, applying them properly remains a challenge. The consideration of foreign decisions and legal literature in particular — which is essential for unified interpretation — may require intensive research and extensive efforts that a state court judge may not be able to make,<sup>34</sup> at least not in courts of lower instance.<sup>35</sup> This holds particularly true in States that can only provide their courts with very limited resources.

To facilitate this task, UNCITRAL supplies multiple tools, including case law digests<sup>36</sup> and the case law on UNCITRAL texts (CLOUT) database.<sup>37</sup> The (ongoing) legal education of judges likewise remains essential. Although these steps are valuable, they cannot guarantee unified interpretation and application. Apparently, however, not much can be done beyond the aforementioned to facilitate unified interpretation of model-law-based provisions. The only exception would be the establishment of an international court that holds exclusive jurisdiction over the interpretation of harmonized law.<sup>38</sup> Being required to delegate sovereignty in this manner would, however, most likely diminish the States' willingness to adopt harmonized law.

### *3. Interaction with Other Areas of Law*

An area closely related to unified interpretation is the interaction of model-law-based provisions with other domestic provisions of the State which has enacted the model law.

#### *(a) Interaction with Non-harmonized National Law*

The interaction of model-law-based provisions with non-harmonized provisions merits discussion in two respects.

First, it is irreconcilable with an interpretation of model-law-based provisions as a self-contained body of law (above 2) to assign legal terms in such provisions the same meanings they hold in other areas of law of that State. National legislatures should therefore avoid using legal terms that have a pre-defined meaning in their legal order (including when translating the model law into the State's official language).<sup>39</sup>

Second and more importantly, model-law-based provisions may be inconsistent with other national law. For example, national non-harmonized law may allow judges to be challenged on grounds that do not justify challenging an arbitrator under Art. 12 ICA-ML. This result is inconsistent since impartiality and independence cannot be less essential for arbitrators (if for no other reason than that they are solely appointed by the parties) than it is for judges. Given that the ICA-ML relies on an international consensus, judgments that diverge therefrom can likely be traced back to idiosyncratic domestic rules on challenging judges that can only be revised by the national legislature.

#### *(b) Interaction with Otherwise Harmonized Law*

While the interpretation of model-law-based provisions should not take inspiration from national law, it may well take inspiration from other harmonized provisions, be it conventions or other model-law-based provisions. One example is taking recourse to Option I Art. 7 ICA-ML for interpreting the in-writing

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<sup>34</sup> Cf. *Magnus*, in: Janssen/Meyer, *CISG Methodology*, 2009, pp. 33, 57 and the delegate of the United Kingdom's remark in A/CONF.89/C.1/SR.7: "If that second clause was addressed to judges required to hear cases concerned with carriage by sea, they might become confused as to the what extent they should refer to decisions taken by the courts of 100 or so other countries before rendering their own judgement."

<sup>35</sup> Cf. *Gruber*, *Methoden des internationalen Einheitsrechts*, 2004, p. 200.

<sup>36</sup> A Guide to UNCITRAL (fn. 11), para. 59.

<sup>37</sup> A Guide to UNCITRAL (fn. 11), paras 56 *et seq.*

<sup>38</sup> See *Basedow*, *RabelsZ* 81 (2017), 1, 26.

<sup>39</sup> For an example, see *Wolff*, *AYIA* 2014, 51, 63.

requirement in Art. II NYC.<sup>40</sup> In such cases several harmonized provisions may jointly form a self-contained body of law. Again, however, the adopting State has the final say on the applicable rules of interpretation.

*(c) Interaction with National Modifications to the Model Law*

Model laws can be enacted with modifications. Such modifications do not raise specific interpretative issues as long as they remain separable — these modifications are to be interpreted under domestic law only.

Modifications are less easy to handle if they are inseparably intertwined with national law, for example if they extend the scope of application of a model law. While the ICA-ML is restricted to international commercial arbitration, some States have adopted it as their only arbitration law that also regulates domestic and consumer arbitration. However, rules that are suitable for international commerce (which is UNCITRAL's mandate) are not necessarily viable for domestic consumer disputes to the same extent.

Where there is a dispute involving such inseparably intertwined modifications, it must be determined whether the national legislature intended for the modified provisions to be governed by the same rules in harmonized interpretation in both international commercial and purely domestic cases. This will often be the case since a split interpretation of one and the same set of rules depending on whether the case lies within the originally intended scope of application of the model law is not sensible. Even harmonized interpretation would not, however, disallow taking into account the individual circumstances of each case, even where they are rooted in an extended scope of application. Conversely, caution is advisable if case law from beyond the original scope of the model law is used for comparative interpretation of model-law-based provisions.

*IV. Success Factors for Model Laws*

Having discussed the place they occupy within the system of available instruments for harmonization (above II) and how they function (above III), this paper can now turn to a more detailed analysis of the success factors for model laws.

Success always relies on multiple factors whose identity and interaction cannot be determined with mathematical precision.<sup>41</sup> Success factors can, however, be distinguished by the level on which they take effect: some are of a general nature and apply regardless of which instrument has been chosen for harmonization (below 1), while others are specific to the choice of a suitable instrument, i.e. a model law, as opposed to another instrument (below 2). The third group consists of factors that may contribute to the success of a model law on the level of its implementation (below 3).

*1. Instrument-unrelated Factors*

Since the model law is a specific instrument for the harmonization and modernization of law, it shares some success factors that all instruments have in common. Although these general criteria are of considerable weight, they can only be summarized in a cursory manner as this paper's focus is not on law-making in general.

*(a) Need for Reform*

Since UNCITRAL lacks the power to impose its texts on the States, any harmonizing and modernizing text — regardless of the instrument chosen for it — requires the States' consent. The starting point of any national law reform is therefore the State's perception that the current legislation is in need of reform.<sup>42</sup>

<sup>40</sup> For details, see *Wolff*, in: *Wolff* (fn. 25), Art. II para. 114.

<sup>41</sup> For an empirical approach, see *Efrat*, 60 *International Studies Quarterly* 624 (2016).

<sup>42</sup> *Boele-Woelki* (fn. 15), p. 336 para. 65; on the importance of timing *Estrella Faria* (fn. 26), p. 22.

*(b) Persuasiveness of the Harmonized Regulation*

States will adopt the harmonizing instrument only if doing so promises to yield greater benefits than its alternatives, i.e. enacting non-harmonized law or abstaining from reform altogether.

*(aa) General Criteria for “Good Law”*

A harmonized law will be perceived as good law if its rules honour the legitimate interests of the parties, work in practice and are consistent. A clear and transparent structure contributes to better law to the same extent as simple and clear-cut provisions.<sup>43</sup> For this reason the complexity and length of the provisions on interim measures and preliminary orders in Art. 17 *et seq.* ICA-ML 2006 are not amongst the selling points of this model law.

*(bb) Non-national Character of the Regulation*

While the creation of harmonized law naturally entails a comparative element, the most practical of pre-existing solutions should not simply be identified and adopted. The more easily the harmonized law can be attributed to one specific legal order or tradition, the lower its acceptance by other States is likely to be. This factor contributed to the limited success of the Uniform Law on the International Sale of Goods (ULIS), the CISG’s predecessor, which was perceived as a predominantly Western European instrument.<sup>44</sup>

*(c) Competitive Effects of Harmonized Law Adoption*

In line with the assumptions on which the establishment of UNCITRAL is based (above I), the enactment of harmonized law by a State will usually be accompanied by the expectation that harmonized law will promote international trade and that international trade will contribute to the State’s wealth. Two examples of where the adoption of harmonized law is perceived as providing a competitive advantage are the adoption of the ICA-ML by Germany and Austria in the hopes of becoming more attractive as venues for international arbitral proceedings.<sup>45</sup>

For some States, conversely, competitive advantage is the reason for not adopting harmonized law. Switzerland, France and the United Kingdom, for example, which are frequently chosen as venues for international arbitration, did not adopt the ICA-ML and do not plan to do so. Notably, the strength of these venues is owed more to traditional connotations as a neutral (Switzerland) or business-friendly (United Kingdom) seat than to the content of their national arbitration laws.

*2. Choice of Instrument Factors*

Apart from the general factors for harmonizing texts, the success of a model law also hinges on a number of instrument-specific factors. A model law is likely to be more successful if this instrument in particular is the best choice for a given harmonizing endeavour.

*(a) Need for Flexibility*

The need for flexibility is the single most frequently cited reason for choosing the form of a model law: “The form of a model law was chosen as the vehicle for harmonization and modernization in view of the flexibility it gives to States in preparing new arbitration laws.”<sup>46</sup> This likewise applies to model laws in other areas of law.

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<sup>43</sup> *Estrella Faria* (fn. 26), p. 9.

<sup>44</sup> *Knieper* (fn. 10), p. 665.

<sup>45</sup> Germany: Government bill, BT-Drucks. 13/5274, p. 1; Austria: Nationalrat, XXII. Gesetzgebungsperiode, Regierungsvorlage No. 1158, p. 2; similarly for Singapore *Lim*, 7(1) Asian Int’l Arb. J. 1, 6 (2011).

<sup>46</sup> Explanatory Note by the UNCITRAL secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006, para. 3; similar UNCITRAL Model Law on Electronic Signatures, Guide to Enactment, para. 27.

*(aa) Actual Need for Flexibility*

An actual need for flexibility exists where States are likely to want to make various modifications to the uniform text in order to make it fit into their respective legal orders and where States may not be willing to accept uniform binding solutions.<sup>47</sup> Such modifications are typical where the model law provisions relate to other critical areas of law like the national court system.<sup>48</sup> One example that illustrates this is Art. 8(1) ICA-ML; according to this provision, a court before which an action covered by an arbitration agreement is brought shall “refer the parties to arbitration.” This legal consequence was transformed into “reject the action as inadmissible” in sect. 1032(1) of the German Code of Civil Procedure since German law does not provide for referral to arbitration.

While States can make reservations when acceding to conventions, such reservations are only permitted under certain restrictive circumstances (Art. 19 of the 1969 Vienna Convention on the Law of Treaties). Permitted reservations are often already specified in the convention, which requires a high degree of foresight at the time the convention is drafted. Since such foresight is not always at hand, model laws have an advantage where the uniform text later needs adjusting in order for it to fit into national law.

*(bb) Perceived Need for Flexibility*

Another more psychological factor may be the opportunity to amend the model law text before or after adoption regardless of whether such amendments are needed and of whether they are indeed implemented. Simply having full ownership over the enacted law may in and of itself enhance willingness to adopt harmonized and modernized law and may make it more attractive to implement model laws rather than to accede to conventions. Indeed, amendments to model laws are said to often be made for their own sake.<sup>49</sup>

*(b) Need for Formulated Rules and Standards*

If flexibility were the key advantage of model laws, legislative guides — which are even more flexible — would seem to be the better choice in most cases. However, the desire for flexibility is in fact counterbalanced by the need for formulated rules and standards. While model laws are preferable to conventions where flexibility is needed, they are also preferable to legislative guides where formulated rules and standards are essential.

*(aa) Harmonizing Effect of Rules*

In sharp contrast to the emphasis on flexibility, UNCITRAL and other law-making organizations should strive to replace legislative guides with model laws or conventions wherever possible — provided, of course, that the conditions for model laws are met. The downside to full flexibility in transformation is the often lesser degree of harmonization that such an instrument can actually effect. Given that legislative guides do not provide precisely worded rules to be enacted, their unifying effect is necessarily limited to the underlying policy decisions. This is only of limited assistance for international trade: certainly businesses’ costs for adjusting their transactions to the requirements of several jurisdictions will decrease if these jurisdictions follow the same policies, but transaction costs would be significantly lower still if harmonized law were in effect in these jurisdictions.<sup>50</sup>

Precisely worded provisions should only be abstained from for good reasons. Such reasons include if States use disparate legislative techniques and approaches for solving a given issue.<sup>51</sup> Model law provisions in such cases would often be subject to complete revision before their adoption by a State, which would render the creation of fully-worded provisions as a one-size-fits-all uniform solution useless.

<sup>47</sup> Gopalan, L. & Com. 117, 152 (2003-2004); see also A Guide to UNCITRAL (fn. 11), para. 35.

<sup>48</sup> UNCITRAL Model Law on Electronic Signatures, Guide to Enactment, para. 27; Estrella Faria (fn. 26), p. 22 (on Art. 27 ICA-ML).

<sup>49</sup> Herrmann, Bus. L. Int’l 249, 252 (2001).

<sup>50</sup> See Knieper (fn. 10), p. 666.

<sup>51</sup> A Guide to UNCITRAL (fn. 11), para. 43.

### *(bb) Efforts of Formulating Rules*

Fully-worded provisions are also preferable for another reason, namely that they save the States the efforts of formulating their own bespoke provisions.<sup>52</sup> An example of this is the sanctions regime for businesses that fail to comply with the business register regulations: while it is true that “(t)he Regulation should establish and ensure wide publication of sanctions (including fines, deregistration and loss of access to services) that may be imposed on a business for a breach of its obligations under the Regulation,”<sup>53</sup> the effort to identify the best practice for such sanctions and to draft appropriate regulations remains with the individual State.

If States have to transform several interdependent policy considerations into national legislation, they moreover run the risk of unintended or incoherent results.<sup>54</sup> Being aware of such risk may also prevent States from adopting harmonized law.

These effects are even more pronounced where the State lacks the experience or resources to create and implement proper provisions that meet the requirements of international trade.<sup>55</sup>

### *(cc) Need for Standardization or Otherwise Uniform Solutions*

The general preference for fully-formulated provisions in conventions and model laws becomes a must where the issues at stake require standardization or otherwise uniform solutions. The current discussion on the structure of a unique business identification number may serve as an example: upon request by Working Group I, the Secretariat has prepared “an instrument along the lines of a concise legislative guide on business registration.”<sup>56</sup> While this draft instrument refrains from proposing an internationally standardized unique business identifier, UNCTAD submits that “(i)t would simplify registration and cross border trade and investment if all governments were to agree on a common alphanumeric system for registering businesses that would facilitate identification of a company’s ultimate beneficiary ownership by country.”<sup>57</sup> While this is certainly true, international trade (and the community of States) would be much better served if such system was directly set up in a model law (or convention).

### *(c) Self-contained Area of Law*

Model laws require a confined and self-contained area of law with a limited number of interfaces with other legal areas. This largely follows from the reflections on flexibility (above a) and fully-worded rules (above b): if an area of law is embedded in a larger legal context or closely interwoven with several other areas of law, adopting States would regularly need to make numerous adjustments to the model law provisions. A set of fully-worded provisions is of little use in such a setting. If an area of law of that kind is suitable for harmonization at all, a legislative guide is the preferable instrument.

### *(d) Irrelevance of a State’s Legal Obligation*

States can autonomously adopt model laws and reverse their adoption at any time. The model law is therefore not the proper instrument if other States need legal certainty that a given State will adopt and

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<sup>52</sup> Cf. *Estrella Faria* (fn. 26), p. 30 (“convenient first drafts of modern statutes”).

<sup>53</sup> UNCITRAL Secretariat, A/CN.9/WG.I/WP.96, Recommendation 41.

<sup>54</sup> *Cohen*, Unif. L. Rev. 325, 330 (2010).

<sup>55</sup> See *Cohen*, Unif. L. Rev. 325, 329 (2010).

<sup>56</sup> UNCITRAL Secretariat, A/CN.9/WG.I/WP.96 para. 1.

<sup>57</sup> UNCTAD, A/CN.9/WG.I/WP.98, p. 5.



remain true to a specific set of harmonized rules. One example of this is where regulations are adopted on the basis of reciprocity.

*(e) Efforts for Setting up the Instrument*

A final argument for favouring model laws over conventions is the effort required to develop the instrument. Conventions are usually concluded at a diplomatic conference or in the United Nations General Assembly,<sup>58</sup> which has proven to be time-consuming and costly.<sup>59</sup> Model laws, on the other hand, do not require such an involved conclusion procedure.

*(f) Final Remark: the Political Factor*

It is one thing to have a clear understanding of the factors for a proper choice of instrument and another to make a choice according to these insights.

The choice of instrument is not imposed by the UNCITRAL Secretariat or any other administrative body. It is rather the result of what the States represented in UNCITRAL and its Working Groups could agree on. Since decisions are usually taken by consensus,<sup>60</sup> the process inherently runs the risk of ending up with the smallest common denominator in terms of the instrument's harmonizing effect.

This risk is increased by the fact that the choice of instrument is often only discussed at a relatively late stage. States that do not feel comfortable with the substance of the proposed harmonizing rules can still easily opt for an instrument with a lesser harmonizing effect at this stage.

*3. Model Law Implementation Factors*

The final group of success factors for model laws relates to their technical implementation.

*(a) Interfaces with Other Areas of Law*

Since model laws require a confined and self-contained area of law with a limited number of interfaces with other legal areas (above 2. c), care should be taken when tailoring a model law's scope of regulation. Interfaces with other areas of law should be small in number and clear in demarcation. For this reason, it was a wise decision not to go into the details of court proceedings in the ICA-ML but to restrict the rules to the absolute minimum in this respect. The same would hold true for a model company law and its interfaces with regulations on business registers. Indeed, as long as the aforementioned interfaces are kept to a minimum, the ability to make minor modifications to model laws is one of their best features (above 2. a) aa).

*(b) Use of Neutral Legal Terminology*

Legal terms in model-law-based provisions should not be assigned the meaning they have in other areas of law of that State. Not only States enacting model laws (above III. 3. a) but also the makers of model laws must be aware of this risk. The makers can minimize it by avoiding terms that are likely to have a specific legal meaning (e.g. "due process") and instead making use of non-technical terms (e.g. "full opportunity to present one's case").<sup>61</sup>

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<sup>58</sup> See fn. 12.

<sup>59</sup> UNCITRAL Secretary-General, A/CN.9/203, para. 119; UNCITRAL Secretary-General, A/CN.9/207, para. 26; Cohen, 36 Brook. J. Int'l L. 567, 582 (2011); Gopalan, L. & Com. 117, 152 (2003-2004).

<sup>60</sup> Knieper (fn. 10), pp. 662 *et seq.*

<sup>61</sup> Herrmann, Unif. L. Rev. 483, 489 (1998); similarly Estrella Faria (fn. 26), p. 9.

*(c) Reconciliation with Otherwise Harmonized Law*

New model laws should, to the extent possible, be reconciled with pre-existing harmonized texts to allow for harmonic interaction (above III. 3. b).

*V. Conclusion*

The model law is a relatively new legislative instrument. Its characteristic features are that States are free to adopt it fully or in part and that it becomes part of the State's domestic law once it is adopted. A convention, conversely, cannot be modified by the States (apart from reservations under strict conditions) and remains autonomous law. Since model laws do not create autonomous law, it is difficult to ensure uniform interpretation and application of model-law-based provisions. This difficulty can, however, be overcome by the States in large part since the available means of interpretation can be adjusted accordingly. Provisions like Art. 2 A ICA-ML can assist in this task.

Success factors for model laws include instrument-unrelated factors, factors that make model laws a superior choice to other types of instrument for a given regulation and factors relating to the implementation of the model law. Among the most important factors for choosing the proper instrument is the weighing of a real or perceived need for flexibility against the need of States and businesses for uniform rules. The area of law dealt with in a model law should be self-contained with a limited number of clearly defined interfaces with other legal areas.

Model laws have not been subject to extensive research to date. A better understanding of this instrument is, however, vital for the successful creation of further model laws and for the effective use of UNCITRAL's resources. This paper has attempted to undertake a first step to further such understanding.

*Harmonization of National Legislation through Model Laws: From the United Nations  
Commission on International Trade Law to the League of Arab States and the Gulf  
Cooperation Council*

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*Introduction*

In its productive efforts to remove barriers in international trade and reconcile differences in legal systems, the United Nations Commission on International Trade Law [UNCITRAL] adopts model laws that provide guidance for national legislation in enacting new laws or amending and changing existing ones.

In the Arab region, the impact of the UNCITRAL Model Law on International Commercial Arbitration, for instance, is a testimony to this success story.

In the meantime, the Arab countries have their own regional model laws that are intended to achieve their goal in establishing a “close cooperation of the member states... in... economic and financial matters including trade, customs, currency, agriculture, and industry”, as stipulated in the charter of the league of the Arab states.

This process started in 1981 with the famous Sanna Strategy, a great number of model laws were drafted by the League of Arab States [LAS] that covered proof of civil and commercial transactions through technology, civil law, combating cyber-crimes, human trafficking and corruption, electronic commerce, legal aid, Arabic judiciary, among others.

The Charter of the Gulf Cooperation Council [GCC] similarly states that it aims to “formulate similar regulations in various fields including... economic and financial affairs, commerce, customs and communications”.<sup>1</sup>

More recently, the GCC adopted model laws on trademarks, regulations of the financial markets, issuance of investment funds, combating dumping through remedies and preventive measure and several others.

The purpose of this paper is to present the first comprehensive, although brief, analysis of these model laws. I will examine the origin of the Arab model laws and whether they rely on international standards including those embodied in the works of the UNCITRAL. I will debate their impact on national legislation in Arab laws and whether they provide guidance in drafting domestic laws irrespective of their non-binding nature. I will argue that reforming and modernizing commercial and trade laws in Arab legal systems are contingent upon learning from comparative models and best global practices.

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<sup>1</sup> Article (4). The Article adds that the GCC aims at fostering scientific and technical progress in industry, mining, agriculture, water and animal resources as well as establishing scientific research centers and setting up joint ventures. For an analysis of the integration policies of the GCC, see, Nasser Al-Mawali, Intra-Gulf Cooperation Council: Saudi Arabia Effect, 30 Journal of Economic Integration 532 (2015).

The UNCITRAL Model Law on International Commercial Arbitration was adopted in 1985 and amended in 2006. It had a great influence on arbitration laws in the Arab region.<sup>2</sup>

For instance, in 2012 the Kingdom of Saudi Arabia adopted a new arbitration law which is based on the UNCITRAL Model Law on International Commercial Arbitration although requiring the arbitration process not to “violate Sharia”, and the arbitration award not to contradict the public order of the Kingdom, which is based on Islamic law. Nonetheless, except for this limited public policy exception, “arbitration awards issued in accordance with this law are not to be challenged in any way except through the filing of a lawsuit to nullify an arbitration award according to the provisions of this law”<sup>3</sup>. Thus, the law limits the interference of courts in the arbitration process.

In 2015, Bahrain in its new arbitration law stated explicitly that “The provisions of the UNCITRAL Model Law on International Commercial Arbitration Act attached to this law shall apply to all arbitration whatever the nature of the legal relationship of the dispute therewith, if this arbitration takes place in the Kingdom of Bahrain or abroad and that the two parties agreed to comply with the provisions of the attached law”.<sup>4</sup>

In Egypt, the Cairo Regional Center for International Commercial Arbitration, in one of its awards explicitly referred to article 21 of the UNCITRAL Arbitration Rules and article 22 of the Egyptian Arbitration Law.<sup>5</sup> The Cairo Arbitration Center was the second institution, after the Kuala Lumpur Regional Center for Arbitration in Malaysia, to adopt new rules of arbitration based upon the UNCITRAL Model Law on International Commercial Arbitration.

This trend in the Arab region, whether in the law or in settlement of disputes is consistent with the General Assembly’s resolution that recommended that “All states give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice”.<sup>6</sup>

<sup>2</sup> See Nayla Comair — Obeid, *Salient Issues in Arbitration from an Arab Middle Eastern Perspective*. 4 The Arbitration Brief 52 (2014) concluding that “what we are witnessing in the Arab Middle Eastern region is a new trend: a newfound appreciation for Arbitration as a viable means of dispute resolution”. [Id at 74]. The author observes that while Oman and Bahrain have strictly followed the UNCITRAL Model Law on Arbitration, Egypt, Jordan, and Tunisia have mainly relied on the Model Law in drafting their national arbitration laws. [Id at 54].

<sup>3</sup> Article 49. See generally Arthur, *Arbitration in the Islamic Middle East*, 5 Santa Clara Journal of International Law 2006 concluding that “the day will inevitably come when mutual commercial interests will intertwine and become so interdependent that international private law and Islamic law will stand where neither dominates the other; this day will be predicated on a mutual respect and understanding for each body of law, including its historical foundations and modern application” (Id at 193). See also, Faisal Kutty, *The Sharia Factor in International Commercial Arbitration*, 28 Lay. L.A. Int’l & Comp. L. Rev 565 (2006) concluding that “There is a need to reform Islamic Law from within to deal with contemporary norms, transactions, and institutions, but there is an equal need to better accommodate and address the issues of concern from an Islamic Perspective. [Id at 623] see also, Radwa S. Elsaman, *Factors to be considered before Arbitrating in the Arab Middle East: Examples of Religious and Legislative Constraint*, 1 Arbitration Brief 8(2011).

<sup>4</sup> Article 1 (1) of the law of Arbitration of Bahrain. But see Jose Angelo Esteralla Faria, *Legal Harmonization Through Model Laws: The Experience of the United Nations Commission on International Trade Law (UNCITRAL)*, arguing that “a certain level of variation — for instance to ensure conformity with the local drafting style or to better reflect local economic conditions or legal tradition — may be appropriate, or even necessary, where the primary purpose of adopting an international model is to modernize the law. Changing the text of a model law to conform to the local style of drafting or to fit squarely the legal status quo may be neither counter-productive...” [Id at 31].

<sup>5</sup> Cairo Regional Center for International Commercial Arbitration, case No 67/1995. Decided August 11, 1996. The Center proposes the following model arbitration clause “Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the Rules of Arbitration of the Cairo Regional Center for International Commercial Arbitration.”

<sup>6</sup> The General Assembly: Resolution 40/72, of December 11, 1985. In 2006, an important article was added stating that “In the interpretation of this law regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith”. [Article 2(1)] This observance is consistent with

## *The influence of the UNCITRAL Model Laws on Electronic Commerce and Electronic Signature in the Arab Region*

Similarly, most Arab laws on electronic commerce are based on the UNCITRAL Model Law on Electronic Commerce of 1996 and the UNCITRAL Model Law on Electronic Signatures of 2001. For instance, the law of Qatar No. 16 of 2010 regarding Electronic Transactions and Commerce provides that information in a contract of a transaction shall not be denied effect, validity, or enforcement on the grounds that it is in the form of a data message.<sup>7</sup>

### *An Arab strategy for the Unification of Arab legislation*

The Yemen strategy of 1981 or the “Sana’a strategy for the unification of Arab Legislation” called for the unification of the laws in the Arab region in accordance with the principles of Islamic law.<sup>8</sup> In 1982, a number of committees were established to adopt model laws as a guide for national legislators. In 1988, the first model law was adopted by the LAS in the area of personal status.

### *An Agreement or a Convention and a Model Law: Two Instruments of Unification of Arab Law*

There are several means of unification of Law in the Arab world. For instance, there have been a great number of agreements or conventions that have been drafted and that are binding on Arab states once they are ratified. These binding agreements have been simultaneously accompanied by a number of “soft” law instruments such as a model law.

For instance, in the important area of combating human trafficking, especially for the purpose of forced labour, the Arab Charter on Human Rights of 2014 prohibits “All forms of slavery and trafficking in human beings” as well as “forced labour”.<sup>9</sup>

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the mandate of the UNCITRAL in “promoting ways and means of ensuring a uniform interpretation and application of international conventions and uniform law in the field of the law of international trade”. The UNCITRAL has adopted several model laws that followed the Model Law on International Commercial Arbitration of 1985. These included the Model Law on International Credit Transfers (1992), the Model Law on Procurement of Goods, Construction and Services (1994), the Model Law on Electronic Commerce (1996), the Model Law on Cross-Border Insolvency (1997), the Model Law on Electronic Signatures (2001), the Model Law on International Commercial Conciliation (2002) and the Model Law on Secured Transactions (2016) which applies to security rights, a term which is defined as “a property right in a movable asset that is created by an agreement to secure payment of an obligation, regardless of whether the parties have denominated it as a security right, and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation, and the right of the transferee under an outright transfer of a receivable by agreement” (Article 2). See also, the UNCITRAL Legislative Guide on Secured Transactions (2010).

<sup>7</sup> Article 4 of the law of Qatar No. 16 of 2010 regarding Electronic Transactions and Commerce, equivalent to Article 5 of the UNCITRAL Model Law on Electronic Commerce of 1996. Article 28 of the Qatari law recognizes an electronic signature in accordance with the requirements specified in article 6 of the UNCITRAL Model Law on Electronic Signatures of 2001. See also, the Law of Tunisia No. 83 of 2000, the Law of Jordan No. 58 of 2001, the Law of the United Arab Emirates No. 2 of 2002, See e.g., Stephen E. Blythe, Fine Tuning the E-Commerce Law of the United Arab Emirates: Achieving the Most Secure Cyber Transactions in the Middle East, 1 International Journal of Business and Social Sciences 1 (2010). See also, the law of Bahrain No. 28 of 2002 regarding electronic transactions and commerce.

<sup>8</sup> The Sana’a strategy adopted the Holy Quran and the traditions of the Prophet as the basis for application of Islamic law, without relying on any particular jurisprudential doctrine. It considered “principles of justice: that do not contradict Islamic law, as a source of codification of the laws. It also made it clear that such process should be “gradual” and should take into consideration the special circumstances of every state. This influence of Islamic law is seen in the Arab model Civil Law of 1996 that contained an introductory part covering rules of Islamic jurisprudence that should be utilized in the interpretation of the different articles of the model Civil Law. Other model laws did not pay too much attention to Islamic law in the process of drafting.

<sup>9</sup> Article 10 of the Arab Charter on Human Rights provides that “[1] All forms of slavery and trafficking in human beings are prohibited and are punishable by law. No one shall be held in slavery and servitude under any circumstances. [2] Forced labour, trafficking in human beings for the purposes of prostitution or sexual exploitation, the exploitation of the prostitution of others, any other form of exploitation or the exploitation of children in armed conflicts are prohibited”. For a discussion of the Arab Charter on Human Rights, see Mohamed

The Arab Convention against Transactional Organized Crime of 2012 calls upon Arab states to take the necessary measures in their domestic laws to criminalize any act committed by an organized criminal group including the act of human trafficking.<sup>10</sup>

The Arab Convention on Combating Information Technology Offences of 2010 includes “Traffic in persons” as well as “Traffic in human organs” as “offences related to organized crime committed by means of information technology”.<sup>11</sup>

These are binding regional instruments. In the meantime, the League of Arab States adopted two “soft” instruments, an Arab strategy to combat human trafficking<sup>12</sup>, and a Model Law which had a significant impact on anti-trafficking legislation<sup>13</sup> that were adopted in Sudan, Morocco, and Tunisia subsequent to the issuance of the Model Law.<sup>14</sup>

Similarly, in the area of combating corruption, the League followed the same dual methodology relying on both instruments, thus adopting the Arab Convention against Corruption in 2010<sup>15</sup>, and the Arab Model Law against Corruption in 2012.<sup>16</sup>

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Y. Mattar, Article 43 of the Arab Charter on Human Rights: Reconciling National, Regional, and International Standards, 26 Harvard Human Rights Journal 91 (2013). I argued that “the Arab Charter on Human Rights provides a comprehensive and adequate platform for human rights promotion and protection in the region, provided that its provisions are properly interpreted in light of international standards embodied in international conventions” Id at 147.

<sup>10</sup> Article 11 of the Arab Convention on Combating Transnational Organized Crime of 2012. See generally, Mohamed Y Mattar, Corporate Criminal Liability: Article 10 of the Convention against Transnational Organized Crime, 66 Journal of International Affairs, Columbia University, School of International and Public Affairs 107 (2012).

<sup>11</sup> Article 16 of the Arab Convention on Combating Information Technology Offenses. The purpose of this Convention “is to enhance and strengthen cooperation between the Arab States in the area of combating information technology offenses to ward off the threats of such crimes in order to protect the security and interests of the Arabs states and the safety of their communities and individuals.” [Article 1]. The Convention defines “Information technology” as “any material or virtual means or group of interconnected means used to store, sort, arrange, retrieve, process, develop, and exchange information according to commands and instructions stated therein. This includes all associated inputs and outputs by means of wires or wirelessly in a system or network.” [Article 2].

<sup>12</sup> See “The Comprehensive Arab Strategy for Combating Trafficking in Human Beings” adopted by the Council of Arab Ministers of Justice Resolution No. 879 — 27 of February 15, 2012. The Arab Strategy is based on 8 focus areas, including criminalizing all types and forms of trafficking in human beings, ensuring effective investigation, indictment and trial in human trafficking crimes, strengthening prevention measures and procedures, victims protection, strengthening regional and international cooperation in combating trafficking in human beings, strengthening national institutional capacities for combating the crime, updating the Arab Model Law on Combating Human Trafficking and ensuring coordination of efforts to combat human trafficking in the Arab region.

<sup>13</sup> For a discussion of the status of anti-trafficking laws in the Arab world, see Mohamed Y. Mattar, Human Rights legislation in the Arab World: The Case of Human Trafficking, 33 Michigan Journal of International Law’ (2011). Except for Libya, Yemen and Palestine, every Arab country has passed a law on combating human trafficking. Several laws have provided for the principle of non-punishment of a victim of trafficking in accordance with the international standards on the rights of a victim of a crime. On drafting anti- trafficking legislation, see generally, Mohamed Y. Mattar, Incorporating the Five Basic Elements of a Model Anti-trafficking in Persons Legislation in Domestic Laws: From the United Nations Protocol to the European Convention, 14 Tulane J. Int’L and Comp. L. 357 ( 2006).

<sup>14</sup> The Model Law follows the definition of trafficking in persons as stipulated in the United Nations Protocol to prevent, suppress, and punish trafficking in persons, especially women and children of 2000, which defines exploitation to include “at a minimum, the exploitation of the prostitution of others or other forms of sexual exploitation, forced labour or services, slavery or practices similar to slavery, servitude or the removal or organs” [Article 3]. It is noted that the law of Sudan unlike the laws of Morocco and Tunisia, does not enumerate a list of exploitation, as does the protocol. Instead, the law focuses on any act that degrades human dignity or achieve unlawful aims. [Article 7].

<sup>15</sup> Arab Anti-Corruption Convention (League of Arab States 2010) which aims at “fostering integrity, transparency, accountability, and the rule of law (Article 2).

<sup>16</sup> Arab Model Law Against Corruption (League of Arab States 2012).

## *Incorporating Arab Model Laws in Domestic Legislation*

To what extent are these model laws effective? Do they have an impact on domestic legislation? Can a judge refer to them in interpreting the national law?

A model law, by definition, is not binding. It only serves a guide for the national legislator in enacting a law or amending an existing one.

In some instances, a national legislator may rely upon a model law. For example, the law of customs No. 40 of 2002 of Qatar makes an explicit reference to the Model Law on Customs that was adopted by the GCC. Similarly, the United Arab Emirates customs law No. 85 of 2007 applies the GCC Model Law on Customs.

This incorporation of the model law into the national law is the only way a judge may give effect to the model law. One would like to see judicial decisions that use a model law or an international principle or a guideline, at least in the interpretation of a national law regardless of its non-binding nature. Judicial discretion in such circumstance may find authority in the concept of “justice” which a judge may apply to achieve equity in a particular case. This reinterpretation of the notion of “judicial interpretation” would also give effect to the rise of model laws and their preference over conventions, as means of unifying and harmonizing national laws especially in the area of investment, commerce and trade.

## *The Development of Arab Civil Law away from the methodology of the Model Law*

Some of the Arab model laws did not impact national legislation. For instance, the Arab Civil Law of 1996 was drafted by the Arab league based upon the Jordanian Civil Code of 1976 and the United Arab Emirates Code of Civil Transactions of 1985, both of which were influenced by Islamic Law. Consequently, the Arab Civil Code contained 85 introductory articles drawn from Islamic jurisprudence. Nonetheless, both the Qatari Civil Code of 2004 and the more recent Civil Code of Oman of 2013 did not follow this methodology. Instead, they were influenced by the Egyptian Civil Code of 1949, which followed the French model of codification.<sup>17</sup>

## *Model Laws as a Vehicle for Introducing Legal Development*

Model laws may also serve as a vehicle to introduce current legal developments. For instance, the GCC Model Law on Combating Information Technology Crimes of 2013 criminalizes establishing a website or spreading information on the internet to facilitate or publicize programs or ideas that may violate the public order and good morals<sup>18</sup>. The law also penalizes the use of the internet to commit an act of prostitution<sup>19</sup>, or place information or pictures or recording that may infringe upon private life<sup>20</sup>, or with the

<sup>17</sup> See generally, Nabil Saleh, *Civil Codes of Arab Counties: The Sanhoury Codes*, 8 Arab L.Q 161 (1993). See also K. Zurgert & H. Kotz, *Introduction to Comparative Law* 110 (1997) stating that “although Abu Sanhoury and the Egyptian legislator emphasized that Islamic law was considered throughout in the preparation of the Code, the Code appears, on closer investigation, to be principally oriented towards French law, and it contains only a few rules of Islamic origin, such as those relating to the gift and preemption”. It is also noted that Islamic law was only considered as a subsidiary source of law. Article 1 of the Egyptian Civil Code clearly provides that “In the absence of any applicable legislation, the judge shall decide according to the custom and failing the custom, according to the principles of Islamic law. In the absence of these principles, the judge shall have recourse to natural law and the rules of equality”. It is to be observed that the Qatari Civil Code of 2004 and the Omani Civil Code of 2013 make Islamic law, not customs, the first subsidiary source of law. Nonetheless, the impact of Islamic Law on commercial transactions is minimal except for the prohibition of interest. For a discussion of the compatibility of Islamic Law and the CISG regarding the issue of interest, see generally, T.S. Twibell, *Implementation of the United Nations Convention on Contracts for the International Sales of Goods (CISG) Under Shari’a (Islamic Law) : Will Article 78 of the CISG be Enforced When the Forum is in an Islamic State?*, 9 INT’L Legal PERSP.25 (1997).

<sup>18</sup> Article 28.

<sup>19</sup> Article 21.

<sup>20</sup> Article 23.

intent to commit an act of trafficking in persons or in human organs<sup>21</sup>, or any act that degrades the Islamic religion or any other religions<sup>22</sup>.

There is a need to introduce more model laws that reflect recent developments in the law. One may suggest a model law in the area of franchising based upon the UNIDROIT Model Franchise Disclosure Law of 2013, especially since Arab national laws still rely on the traditional rules of commercial agency and lack a comprehensive law that covers all aspects of a franchise licensing arrangement. One may also suggest an Arab model law on alternative dispute resolution (ADR) that builds upon and learns from the provisions of the Federation International Des Ingenieurs Conseils (FEDIC). One may also suggest an Arab model law in the area of environmental protection reconciling investment legislation with the new challenges posed by climate change. One may also suggest an Arab model law on insolvency that draws on and borrows from the UNCITRAL Model Law on Cross-Border Insolvency of 1997 and its Guide to Enactment and Interpretation of 2013. One may also suggest an Arab model law on secured transactions based upon the UNCITRAL newly adopted Model Law on Secured Transactions of 2016. Perhaps the LAS or the GCC would consider endorsing the UNCITRAL Model Law on Secured Transactions as the Arab model law on this important and innovative subject. One may also propose an Arab model law in the area of international sales reflecting the international standards embodied in the UNCITRAL Convention on Contracts for the International Sales of Goods (CISG). Perhaps building consensus around a model law would encourage more Arab states to ratify the convention which provides a very clear and widely acceptable statement of the law of international sales.

### *Compliance of Model Laws with International Standards*

An example of compliance with international standards, is the GCC Model Law on Commercial Trademarks of 1996 as amended in 2006 and 2012, which follows the TRIPS Agreement. The Model Law provides for a one year protection period<sup>23</sup> that may be renewable for similar periods. The Model Law provides that the holder of a trademark which is confusing to the public or contains false statements regarding its source of the products or services, may not be registered<sup>24</sup>. Both documents define a trademark, which is protectable to include “any sign or any combination of signs, capable of distinguishing the foods or services of one undertaking from those of other undertakings”. It is noted that U.A.E, Qatar, and Bahrain have adopted the Trademark Model Law as the applicable law<sup>25</sup>, thus replacing the local trademark laws of the GCC countries<sup>26</sup>. This is a significant trend in accepting model laws in national legal systems in the Arab world. This trend should be encouraged if we are serious about unifying and harmonizing the Arab laws, especially in the area of investment, trade and commerce.

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<sup>21</sup> Article 25.

<sup>22</sup> Article 22. See also the Law of Sudan on Combating Human Trafficking of 2014 which explicitly provides that “there shall be deemed to have committed an offence, whoever uses the internet, or establishes a website, with the intent to commit any of the offenses stipulated in this Act, and shall be punished with imprisonment, for a term not to exceed five years or with a fine, or with both.” (Article 14). See also the Law of Iraq on Combating Human Trafficking of 2012 (Article 7).

<sup>23</sup> Article 21. According to article 18 of the TRIPS agreement, a trademark shall be protected for a period of no less than 7 years.

<sup>24</sup> Article 3. See article 15 of the TRIPS agreement. See generally, Amir H. Khoury, “Measuring the Immeasurable “The Effects of Trademark Regimes : A Case Study of Arab Countries, 26 Journal of Law and Commerce 11(2006-07).

<sup>25</sup> Article 15 of the TRIPS Agreement, equivalent to article 2 of the Arab Model Law on Trademarks. Article 15 continues, “Such signs, in particular words including personal names, letters numerals, figurative elements and combination of colours as well as any combinations of signs, shall be eligible for registration as a trademark.

<sup>26</sup> See e.g. the law of Bahrain No. 6 of 2014 approving the Trademark law of the Gulf Cooperation Council States, implemented by Decision No. 65 of 2016 issuing the Implementation Regulation for the Trademark law of the Gulf Cooperation Council States, approved by law No. 6 of 2014. See also the Qatari Decree No. 18/2007 and the United Arab Emirates Federal Decree No. 52/2007. Although the GCC Trademark Model Law does not provide for a unified filing system, applications for trademark protection are to be filed separately in each country.



Some of the Model Laws adopted by the League of Arab States and the Gulf Cooperation Council must be amended in light of newly developed international standards. For instance the right to legal aid is organized by different provisions in the Model Law on Criminal Procedures issued by the GCC<sup>27</sup> of 2010, the GCC Model Law on the Practice of the Legal Profession of 2002<sup>28</sup> and the Arab League Model Law on Judicial Aid of 2008<sup>29</sup>. These Model Laws restrict the right to provide legal aid to lawyers and are mainly intended to provide legal aid to an accused who is unable to afford a lawyer. These rules should be reconsidered in light of the United Nations Principles and Guidelines on Access to Legal Aid in Criminal Justice Systems<sup>30</sup> and the United Nations Model Law on Legal Aid. Both adopt a broad concept of legal aid and expand on those who may provide legal aid and those who are entitled to receive it.<sup>31</sup>

Model laws may then become a vehicle for enhancing human rights and an instrument for legal reform. One may think about a model law on the establishment and operations of non-governmental organizations addressing the important role civil society plays in monitoring the application and enforcement of the law, whether it relates to combating corruption, corporate social responsibility, tax, privatization, corporate governance or foreign direct investment in the Arab world. One may also think about a model law on human rights in business holding companies doing business in the Arab world to international standards especially in the area of labour rights. It is encouraging that the GCC issued in 2013 guiding principles for corporate governance applicable to financial markets companies to ensure transparency and disclosure by the board of directors towards shareholders, creditors, interested parties and the public. It is also encouraging that in 2015 the GCC adopted its own human rights declaration, “pursuant to the GCC Charter which provides for the common destiny and the unity of aim which link their peoples, and which calls for coordination, integration and interconnection between them in all fields, as well as deepening and strengthening of bonds, ties and cooperation between their peoples in various fields...” (Preamble).

## *Conclusion*

I hope that my paper will “contribute to the body of knowledge on the law of international trade and further the work of the UNCITRAL” by discussing these “regional activities of (the Arab Countries) in commercial legal reforms (s)” and “modernizing (their) commercial legal systems” through model laws.<sup>32</sup>

<sup>27</sup> See Article 5 and 245.

<sup>28</sup> See Article 5 and 39.

<sup>29</sup> The Model Law is applicable to natural persons and legal persons who are engaged in public interest work that benefits the society. While this expansion in legal aid beneficiaries is to be applauded, the law fell short of providing for all aspects of legal aid. There is a need for a more comprehensive legal aid law that addresses the needs of the vulnerable populations in the Arab world. For a definition of the vulnerable, see, The United Nations Principles and Guidelines on Access to Legal Aid in Criminal Justice Systems (2013).

<sup>30</sup> The First Principle of the United Nations Principles and Guidelines on Access to Legal Aid in Criminal Justice Systems of 2013 provides that “Recognizing that legal aid is essential element of a functioning criminal Justice System that is based on the rule of law, a foundation for the enjoyment of other rights, including the right to a fair trial, and an important safeguard that ensures fundamental fairness and public trust in the criminal justice process, States should guarantee the right to legal aid in their national legal systems at the highest possible level, including where applicable in the constitution”. [Principle 1 — Right to Legal Aid].

<sup>31</sup> The model law, which I was privileged to co-draft, is based on these guiding principles; non-discrimination [Article 5], right to information [Article 6], protection of vulnerable persons [Article 7], right to early access to legal aid [Article 8], equal right to defence or legal aid beneficiaries [Article 9] and the principle that “Nothing in the present law shall be interpreted as providing a lesser degree of protection than that provided under international human rights conventions applicable to the administration of and access to justice...” [Article 10].

<sup>32</sup> More efforts are needed to engage the Arab countries in the working of the UNCITRAL. For instance, only six Arab countries have ratified the United Nations Convention on Contracts for the International Sale of Goods (CISG); these are Egypt, Syria, Iraq, Mauritania, Lebanon, and Bahrain. See, Amin Dawwas and Yusef Shandi, *The Applicability of the CISG to the Arab world*. Uniform Law Review 813 (2011). This slow acceptance of international rules is also seen in the approach of Arab States to the conventions adopted by The Hague Conference on Private International Law. For instance, The Hague Convention on the Civil Aspects of International Child Abduction of 1980 was ratified only by Morocco and Iraq, although international abduction of children is very common in the Arab world, See generally, Erika Ressa, *International Child Abduction to*

Let us start a constructive and productive dialogue between the UNCITRAL and the League of Arab States and the Gulf Cooperation Council in the area of regional and international model laws.

I have argued that Arab model laws should be utilized not only as a means for the harmonization and unification of Arab national laws but also to introduce recent legal developments especially in the area of commerce, trade and investment. I also argued that Arab model laws should be used to enhance human rights in conducting business and trade and to promote the rule of law and legal reform,

The UNCITRAL model laws should serve as a guide for drafting and enacting a model law in the Arab region. I have suggested drafting an Arab model law on international sales to encourage more ratifications of the UNCITRAL Convention on International Sales of Goods. I have also suggested endorsing the UNCITRAL Model Law on Secured Transactions of 2016 as the Arab model law. A close cooperation with the UNCITRAL when drafting a regional model law is imperative<sup>33</sup> to ensure compliance with international standards and comparative models.

While the League of Arab States and the Gulf Cooperation Council adopted several model laws in different areas of the law, the impact of these model laws is still insignificant. Unlike the great influence of a UNCITRAL model law, whether in international commercial arbitration, electronic commerce or electronic signature, on Arab national laws, regional model laws generally lack such impact. Learning from the UNCITRAL model laws experience, and perhaps endorsing the UNCITRAL model laws, would contribute to a better understanding of the role of model laws in unification and harmonization of the law in the Arab region and beyond.

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non- Hague Convention: The need for an International Family Court, 2 NW.J.Int'L.Hum. RTS, 1(2004). HCCH members from the Arab countries include only Egypt, Jordan, Morocco, Saudi Arabia and Tunisia. Similarly, only Egypt, Iraq, Saudi Arabia and Tunisia are members of the International Institute for the Unification of Private International Law " UNIDROIT". In the meantime, the impact of the UNIDROIT Principles of International Commercial Contracts on Arab commercial transactions has not yet been felt, unlike other legal systems. See generally, Michael Bonell, The UNIDROIT Principles of International Commercial Contracts: Achievements in Practice and Prospects for the Future, 17 Australian International Law Journal 177 (2010).

<sup>33</sup> In September 2012, as the executive director of the Protection Project, I held a regional conference in Beirut on the "Harmonization of the law: the Hague Conference, the UNIDROIT and the UNCITRAL", In March 2014, I launched the Arabic version of the UNIDROIT and in December 2014, we were privileged to hear from the UNCITRAL in an Arab regional conference which I organized in Siracusa, Italy. Qatar University College of Law will organize the 2018 International Association of Law Schools annual meeting. I intend to chair a panel on incorporating international standards in commerce, instruments and trade in educational curriculum in Law Schools. In my judgment, Arab model laws do not receive attention in any of the academic courses taught in law schools in Arab universities. Reform of Arab legal education is needed to integrate new developments including the rise of model laws as a means for the unification and harmonization of the law.

## ***Session 2 — Opportunities and challenges in the use of UNCITRAL models***

### *International Insolvency Law's Cross-Roads and the New Modularity*

*John Pottow, University of Michigan Law School, United States of America*

UNCITRAL has been modernizing international trade law for a half-century. Its Model Law on Cross-Border Insolvency has been heralded as a success in integrating various legal traditions to take incremental steps towards the establishment of harmonized bankruptcy procedures.

But this project now stands at a cross-roads. Some have complained that far from being a success, the Model Law is a failure due to its purportedly disappointing adoption rate. Calls have consequently been raised to jettison the soft law approach altogether and switch gears to treaty negotiations. Others have noted that the Model Law will never realize its full potential until it tackles the questions of corporate groups for multinational debtors, which its tentative forays in the Legislative Guide have been insufficient to achieve. And still others have complained that the first wave of fixes to the Model Law is already required, noting the European Union's "recast" of its cognate Insolvency Regulation. Thus, the cross-roads: should UNCITRAL amend the Model Law, supersede it with a convention, or try something else?

The cross-roads reflect the confluence of three challenges: first, an unexpected interpretation of the Model Law by an important enacting state; second, critique from academics, bemoaning perceived imperfections in the Model Law; and third, agitation from a particular NGO important in the international insolvency reform process. And as always, the ever-shifting political dynamics of the "transnational legal order" of international insolvency exert their own pressure. This brief article addresses each in turn before noting UNCITRAL's apparently novel solution of *modularity*.

First, the U.K. *Rubin* decision. Part of the genius of the Model Law was its intentional vagueness, leaving contentious provisions up for ex post interpretation, rather than ex ante pre-specification, enabling "recursive" content revision. But this open-endedness comes with a cost. In *Rubin*, the U.K. Supreme Court propounded an unexpectedly restrictive reading of the Model Law, holding that it forecloses recognition of a U.S. foreign main proceeding judgment when the U.S. court's exercise of *in personam* jurisdiction did not comport with British law. The U.K. court pointedly held that the Model Law's vague references to "cooperation" and intent to foster greater international "assistance" to foreign bankruptcy proceedings were insufficient to provide a statutory foundation. *Rubin* has led calls to amend the Model Law to confirm its cooperative intent.

Next, the academics. An intellectual whipping boy of the Model Law has been COMI, a concept also anchoring the kindred-spirit EU Insolvency Regulation. Numerous commentators complain its undefined standard causes untoward uncertainty. They, too, have called for amendments.

Finally, and likely relatedly, the groundswell of opposition from the International Bar Association, an important NGO whose initial Concordat provided the theoretical foundation for the Model Law. The IBA has spearheaded a glass-half-empty effort to suggest that the Model Law's uptake rate has been a disaster. The IBA even trumpeted a questionnaire, couched as a pseudo-empirical study, showing support for a convention as an alternative to the faltering Model Law. It also arranged informal discussions at two meetings of Working Group V, going so far as to suggest that consideration of the viability of a convention is on the formal agenda per a charge from the Commission. Suffice it to say, this has called the model law "technology" into question.

How has UNCITRAL responded to this methodological cross-roads? With what I call *modularity*. The *Rubin* decision prompted the design of a new model law on cross-border recognition of judgments. It is intended to be *either* a standalone vehicle *or* an addition to the pre-existing Model Law. Thus, UNCITRAL

has doubled down on the model law framework, deploying its flexibility to establish modularity, namely, the ability to build upon, but also function independently from, pre-existing instruments.

This brings us to politics. The simplest solution to a *Rubin* decision getting the Model Law “wrong,” would be to amend the Model Law (or promulgate interpretative guidance), to get it “right.” The standalone recognitions model law does something different. It corrects *Rubin*, but it also makes adoption possible by states still sceptical of the underlying Model Law. This modularity has enabled a State to adopt the new recognitions model law, but *not* the underlying Model Law. This provides political cover to expand cooperative insolvency norms through the side door—achieving some of the same benefit as adopting the Model Law itself.

As for the academics, UNCITRAL has largely ignored them, by which I mean insisting that the perfect not become enemy of the good. But the response to the “threat” of the IBA has been most interesting. Much like when confronted with the infamous French “Observation” that called into question the legitimacy of much of UNCITRAL’s working group practice, the Secretariat responded as it does best: inclusive, fulsome procedure that sets the stage for an issue to die its own death after natural catharsis. While not opposing a convention, it clarified the need for States to demonstrate willingness to get behind a convention, especially so from States not already behind the Model Law. There was no stampede.

Thus, the path forward from the cross-roads seems to be more model laws. Far from path-dependence, this is adroit incrementalism. IBA grumbling notwithstanding, a model law is a nimble and cost-effective technology that allows states to adopt and adapt as need be. It also permits modularity, an important new technological feature with political payoff. This is an important innovation for UNCITRAL, and may well show a new path forward.

*Investment Law and Climate Disputes:  
The Role of the UNCITRAL in Powering Sustainable Development*

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*I. Investment law and the quest for greener sources of energy*

The use of renewable sources of energy, along with the implementation of eco-friendly technologies, plays a pivotal role in addressing the quandaries caused by climate change. The global demand for greener alternatives led to the emergence of an international market for renewable energy technologies and equipment.<sup>1</sup> Over the last decade this market attracted colossal flows of capital.<sup>2</sup> Foreign direct investment is particularly welcome as it can provide fresh funds and induce the transfer of technology.<sup>3</sup> From a broader perspective, foreign investment is a key component of any agenda for sustainable development.<sup>4</sup>

The financial viability of investments in renewable energies is frequently dependent upon public support.<sup>5</sup> All over the world governments have designed and implemented renewable energy support mechanisms so as to encourage private investment, often in the form of subsidies and incentive tariffs.<sup>6</sup> Investments in the energy field are also highly capital intensive and require a lengthy payback period.<sup>7</sup> Regulatory risks loom large — the possibility that the rules in force at the moment the investment was made are altered, threatening the ability of investors to recover and earn a profit on their investments.<sup>8</sup> Governments may decide to change the regulatory framework once investments take place and costs are “sunk.”<sup>9</sup> Changes to economic mechanisms are a critical risk factor surrounding such investments, since the level of public support is the most important element influencing expected profits.<sup>10</sup> Therefore, investors seek to ensure the stability of the regulatory framework that underpins their investments and secure protection from unwarranted policy changes.

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<sup>1</sup> See, generally, RENEWABLE ENERGY: A GLOBAL REVIEW OF TECHNOLOGIES, POLICIES AND MARKETS (Dirk Assmann et al. eds, 2006).

<sup>2</sup> See, e.g., Omar Ellabban et al, Renewable Energy Resources: Current Status, Future Prospects and their Enabling Technology, 39 RENEWABLE AND SUSTAINABLE ENERGY REVIEWS 748, 758 (2014).

<sup>3</sup> Anatole Boute, The Potential Contribution of International Investment Protection Law to Combat Climate Change, 27(3) JOURNAL OF ENERGY AND NATURAL RESOURCES LAW 333, 334 (2009).

<sup>4</sup> Andrew Newcombe, Sustainable Development and Investment Treaty Law, 8(3) JOURNAL OF WORLD INVESTMENT & TRADE 357 (2007).

<sup>5</sup> World Bank, INCLUSIVE GREEN GROWTH: THE PATHWAY TO SUSTAINABLE DEVELOPMENT 22 (2012).

<sup>6</sup> See, e.g., Richard Ottinger & Rebecca Williams, Renewable Energy Sources for Development, 32 ENVIRONMENTAL LAW, 331, 359 ff (2002); Bradford Gentry & Jennifer Ronk, *International Investment Agreements and Investments in Renewable Energy*, in FROM BARRIERS TO OPPORTUNITIES: RENEWABLE ENERGY ISSUES IN LAW IN POLICY 25, 59 ff (pre-publication draft), available at [http://environment.yale.edu/publication-series/documents/downloads/0-9/11-03-Gentry\\_Ronk.pdf](http://environment.yale.edu/publication-series/documents/downloads/0-9/11-03-Gentry_Ronk.pdf) (last visited October 26, 2016); Richard Ottinger et al., *Renewable Energy in National Legislation: Challenges and Opportunities*, in BEYOND THE CARBON ECONOMY: ENERGY LAW IN TRANSITION 183, 186 ff (Donald Zillman et al. eds., 2008).

<sup>7</sup> Yulia Selivanova, *The Energy Charter and the International Energy Governance*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 307, 315 (Christoph Herrmann & Jorg Terhechte eds., 2012).

<sup>8</sup> Boute, The Potential Contribution of International Investment Protection Law 337; Nigel Bankes, Decarbonising the Economy and International Investment Law, 30(4) JOURNAL OF ENERGY AND NATURAL RESOURCES LAW 497, 502 (2012).

<sup>9</sup> Mario Bergara et al., Political Institutions and Electric Utility Investment: A Cross-Nation Analysis, 40(2) CALIFORNIA MANAGEMENT REVIEW 18, 19 (1998); Ralf Dickel, *Impact of Liberalisation on Investment Performance in the Power Sector*, in ELECTRICITY TRADE IN EUROPE: REVIEW OF THE ECONOMIC AND REGULATORY CHALLENGES 69, 76 (Janusz Bielecki & Melaku Desta eds., 2004).

<sup>10</sup> Boute, The Potential Contribution of International Investment Protection Law 342; Economist Intelligence Unit, Managing the Risk in Renewable Energy 10-11, available at <http://digitalresearch.eiu.com/risksandrenewables/report> (last visited October 26, 2016).

International investment agreements have become especially important over the past few decades. These legal instruments aim to create a “level playing field” for investments in the energy sector, and minimize non-commercial risks associated with such investments.<sup>11</sup> These international legal instruments can help lower regulatory and political risks, thus boosting investor confidence and increasing international investments into renewable sources of energy.<sup>12</sup>

Investment agreements are a form of international law that creates a series of obligations owed by the host state towards foreign investors.<sup>13</sup> The numbers of Bilateral Investment Treaties (BITs) and multilateral agreements entering into force have increased throughout the past few decades. The Energy Charter Treaty (“ECT”), a multilateral treaty entered into force in 1998, is the only energy-specific multilateral investment protection mechanism currently in force.<sup>14</sup> While there are differences between the scope and content of the different investment treaties, there is a shared core content: they normally include the obligation to treat foreign investors fairly and equitably; provide foreign investors full protection and security; and not to expropriate foreign investment except under certain conditions, including the payment of compensation.<sup>15</sup> Furthermore, international investment agreements normally contain procedural protections, typically including dispute resolution clauses that enable foreign investors to initiate arbitration proceedings against the host state, known as ‘investor-state arbitrations’.<sup>16</sup>

## *II. The wave of disputes over changes to renewable energy incentives*

With a view to increasing the production of clean energy, many countries introduced incentives to encourage investment in the renewable energy sector. As originally intended, the introduction of these mechanisms led a substantial number of companies and individuals making investments in this field.<sup>17</sup> While economic incentives attracted significant amounts of investment, several countries — namely, Spain, the Czech Republic, Italy, Romania, and Bulgaria — have decided to reduce or eliminate them.<sup>18</sup> These legislative measures have triggered a wave of arbitral proceedings where investors claim that such measures breach the protection afforded by international investment agreements, namely the ECT. As of 15 June 2016, 43 cases had been initiated relating to changes in economic support programs in the renewable energy market.<sup>19</sup>

<sup>11</sup> Kaj Hobér, Investment Arbitration and the Energy Charter Treaty, 1(1) JOURNAL OF INTERNATIONAL DISPUTE SETTLEMENT 153, 155 (2010).

<sup>12</sup> Bradley Condon & Tapen Sinha, THE ROLE OF CLIMATE CHANGE IN GLOBAL ECONOMIC GOVERNANCE 93 (2013).

<sup>13</sup> See, e.g., Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2008); Andrew Newcombe & Lluís Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT (2009); M. Sornarajah, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (2010); Jeswald Salacuse, THE LAW OF INVESTMENT TREATIES (2015).

<sup>14</sup> See International Energy Agency, THE ENERGY CHARTER TREATY: A DESCRIPTION OF ITS PROVISIONS (1994); Thomas Wälde, SUSTAINABLE DEVELOPMENT AND THE 1994 ENERGY CHARTER TREATY (1997); Energy Charter Secretariat, The Energy Charter Treaty: A Reader’s Guide, available at [http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT\\_Guide\\_en.pdf](http://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT_Guide_en.pdf) (last visited October 26, 2016).

<sup>15</sup> See Newcombe & Paradell, Law and Practice of Investment Treaties: Standards of Treatment 147 ff.

<sup>16</sup> See, generally, Campbell McLachlan et al., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2007); Zachary Douglas, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS (2009).

<sup>17</sup> See Onno Kuik & Sabine Fuss, Renewables in the Energy Market: A Financial-Technological Analysis Considering Risk and Policy Options, in FINANCIAL ASPECTS IN ENERGY: A EUROPEAN PERSPECTIVE 33 (André Dorsman et al. eds., 2011).

<sup>18</sup> See Fernando Dias Simões, When Green Incentives Go Pale: Investment Arbitration and Renewable Energy Policymaking, 45(2) DENVER JOURNAL OF INTERNATIONAL LAW AND POLICY 249 (2017).

<sup>19</sup> Cases administered by the ICSID: EVN AG v. Bulgaria (case No. ARB/13/17); RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à.r.l. v. Spain (case No. ARB/13/30); Antin Infrastructure Services Luxembourg S.à.r.l. and Antin Energia Termosolar B.V. v. Spain (case No. ARB/13/31); Eiser Infrastructure Limited and Energía Solar Luxembourg S.à.r.l. v. Spain (case No. ARB/13/36); Masdar Solar & Wind Cooperatief U.A. v. Spain (case No. ARB/14/1); Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italy (case No. ARB/14/3); NextEra Energy Global Holdings B.V. and NextEra Energy Spain Holdings B.V. v.

The anatomy of these cases is substantially different from the prototype of energy-related disputes submitted to arbitration in the past. For years, states have enacted regulations to protect the environment by limiting environmentally detrimental investments. Commentators have expressed concern that investors could initiate arbitral proceedings, claiming that climate-related regulatory measures breached relevant investment treaty provisions. Such cases posed a risk that international investment agreements could have a constraining effect (“regulatory chill”) on climate change mitigation measures and restrain the host-state’s policy space significantly.<sup>20</sup>

Differently, the new wave of disputes refers to cases where states are reducing or eliminating the economic incentives which they introduced years ago in order to lure investments into the renewable energy market. Investors are complaining that such regulatory changes diminish or exhaust the commercial viability of their investments.<sup>21</sup> Host states argue that support mechanisms have proven too popular (and therefore, more expensive than anticipated); that they became too generous because the production costs for the new technology have decreased significantly; or that they simply cannot afford these initiatives due to the ongoing financial crisis.<sup>22</sup> The crux of the question is whether investors can seek compensation under

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Spain (case No. ARB/14/11); InfraRed Environmental Infrastructure GP Limited and others v. Spain (case No. ARB/14/12); RENERGY S.à r.l. v. Spain (case No. ARB/14/18); RWE Innogy GmbH and RWE Innogy Aersa S.A.U. v. Spain (case No. ARB/14/34); Stadtwerke München GmbH, RWE Innogy GmbH, and others v. Spain (case No. ARB/15/1); STEAG GmbH v. Spain (case No. ARB/15/4); 9REN Holding S.a.r.l v. Spain (case No. ARB/15/15); BayWa r.e. Renewable Energy GmbH and BayWa r.e. Asset Holding GmbH v. Spain (case No. ARB/15/16); ENERGO-PRO a.s. v. Bulgaria (case No. ARB/15/19); Cube Infrastructure Fund SICAV and others v. Spain (case No. ARB/15/20); Mathias Kruck and others v. Kingdom of Spain (case No. ARB/15/23); KS Invest GmbH and TLS Invest GmbH v. Spain (case No. ARB/15/25); JGC Corporation v. Spain (case No. ARB/15/27); Cavalum SGPS, S.A. v. Spain (case No. ARB/15/34); E.ON SE, E.ON Finanzanlagen GmbH and E.ON Iberia Holding GmbH v. Spain (case No. ARB/15/35); OperaFund Eco-Invest SICAV PLC and Schwab Holding AG v. Spain (case No. ARB/15/36); Silver Ridge Power BV v. Italy (case No. ARB/15/37); SolEs Badajoz GmbH v. Spain (case No. ARB/15/38); Belenergia S.A. v. Italy (case No. ARB/15/40); Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB v. Spain (case No. ARB/15/42); Holdings S.à r.l. and others v. Spain (case No. ARB/15/44); Landesbank Baden-Württemberg and others v. Spain (case No. ARB/15/45); Eskosol S.p.A. in liquidazione v. Italy (case No. ARB/15/50); Eurus Energy Holdings Corporation and Eurus Energy Europe B.V. v. Spain (case No. ARB/16/4); ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, and InfraClass Energie 5 GmbH & Co. KG v. Italy (case No. ARB/16/5). Cases administered by the Permanent Court of Arbitration under the UNICTRAL rules: Antaris Solar and Dr. Michael Göde v. Czech Republic (registered 8 May 2013). Cases administered by the Arbitration Institute of the Stockholm Chamber of Commerce: Charanne and Construction Investments v. Spain (case No. 62/2012, registered 2012); Isolux Infrastructure Netherlands B.V. v. Spain (registered 2013); CSP Equity Investment S.à.r.l. v. Spain (registered June 2013); Greentech Energy Systems and Novenergia v. Italy (registered 7 July 2015); Alten Renewable Energy Developments BV v. Spain (registered March 2015). Ad hoc cases under the UNCITRAL Rules: PV Investors v. Spain (registered November 2011); Natland Investment Group NV, Natland Group Limited, G.I.H.G. Limited, and Radiance Energy Holding S.A.R.L. v. Czech Republic (registered 8 May 2013); Voltaic Network GmbH v. Czech Republic (registered 8 May 2013); ICW Europe Investments Limited v. Czech Republic (registered 8 May 2013); Photovoltaik Knopf Betriebs-GmbH v. Czech Republic (registered 8 May 2013); WA Investments-Europa Nova Limited v. Czech Republic (registered 8 May 2013); Mr. Jürgen Wirtgen, Mr. Stefan Wirtgen, and JSW Solar (zwei) v. Czech Republic (registered June 2013).

<sup>20</sup> See, e.g., Jacob Werksman et al., Will International Investment Rules Obstruct Climate Protection Policies? An Examination of the Clean Development Mechanism, 3 INTERNATIONAL ENVIRONMENTAL AGREEMENTS: POLITICS, LAW AND ECONOMICS 59 (2003); Stephan Schill, Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change? 24(5) JOURNAL OF INTERNATIONAL ARBITRATION 469 (2007).

<sup>21</sup> Anna De Luca, Withdrawing Incentives to Attract FDI: Can Host Countries put the Genie Back in the Bottle? 2, available at <http://ccsi.columbia.edu/files/2013/10/No-125-De-Luca-FINAL.pdf> (last visited October 26, 2016); Daniel Behn & Ole Fauchald, Governments under Cross-fire? Renewable Energy and International Economic Tribunals, 12(2) MANCHESTER JOURNAL OF INTERNATIONAL ECONOMIC LAW 117, 120 (2015).

<sup>22</sup> Bankes, Decarbonising the Economy and International Investment Law 502; Elizabeth Whitsitt & Nigel Bankes, The Evolution of International Investment Law and its Application to the Energy Sector, 51(2) ALBERTA LAW REVIEW 207, 213-214; James Prest, The Future of Feed-In Tariffs: Capacity Caps, Scheme Closures and Looming Grid Parity, 3(1) RENEWABLE ENERGY LAW AND POLICY REVIEW 25, 34-36 (2012); Del Rio & Mir-Artigues, A Cautionary Tale 12-14; Ioannis Glinavos, *Solar Eclipse: Investment Treaty Arbitration and Spain’s Photovoltaic Troubles*, in LESSONS FROM THE GREAT RECESSION: AT THE CROSSROADS OF SUSTAINABILITY AND RECOVERY 251, 254 (Constantin Gurdgiev et al. eds, 2016).

investment treaties when governments encourage investment via economic support schemes, but decide to reduce or eliminate them after the investment has been made. Again, we may have a clash between energy-related policies and investment law.<sup>23\</sup>

These disputes raise a classic problem in investment arbitration: how to strike a balance between foreign investors' reliance on the regulations that underpin their long-term investments and the host state's right to adapt regulations to new needs.<sup>24</sup> The introduction of changes to economic support mechanisms typically involves governmental measures adopted for public purposes, whether for financial or other reasons. The host state intervenes as the regulation of energy production, distribution and consumption is a key element of national economic law, and policy.<sup>25</sup> The novelty in this new wave of disputes is that challenged measures work against the protection of the environment, while in the past they were eco-friendly.<sup>26</sup>

### *III. Renewable energy policymaking at a crossroads?*

Changes to regulatory frameworks might have a significant impact on what until recently seemed like an unstoppable move towards a low-carbon model of development, jeopardizing the credibility of renewable energy policies and generating high investment uncertainty.<sup>27</sup> These measures may affect the support for renewable energy in both the present and future. Governments may cut agreed subsidies for projects built or under construction but also decide not to grant any support for new projects.<sup>28</sup> If investors have the perception that governments might act opportunistically and change the 'rules of the game' after the investment has been made, they will most likely factor in a risk premium in future projects, increasing the costs of eco-friendly policies.<sup>29</sup>

While some years ago investors were claiming that states had enacted environment-friendly regulations in a way that was detrimental to their investments, the new wave of disputes refers to cases where states are reducing or eliminating the economic incentives which they introduced years ago in order to encourage investments in the renewable energy market. This new category of disputes basically results from the move from the old to the new production matrix.<sup>30</sup>

To date, only one award has been rendered in disputes relating to alterations to economic support programs in the renewable energy market. On 21 January 2016, the tribunal in *Charanne and Construction Investments v. Spain* ruled in favour of the validity of the host state's regulatory changes.<sup>31</sup> While this decision offers important insights into how standards of investment protection might be interpreted and applied in similar disputes, it does not establish any binding precedent. Other arbitral tribunals will have to

<sup>23</sup> Jorge Viñuales, FOREIGN INVESTMENT AND THE ENVIRONMENT IN INTERNATIONAL LAW 17-23 (2012).

<sup>24</sup> See Dolzer & Schreuer, Principles of International Investment Law 145-149.

<sup>25</sup> Markus Krajewski, The Impact of International Investment Agreements on Energy Regulation, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 343, 345 (Christoph Herrmann & Jorg Terhechte eds., 2012).

<sup>26</sup> Rachel Nathanson, The Revocation of Clean-Energy Investment Economic-Support Systems as Indirect Expropriation Post-Nykomb: A Spanish Case Analysis, 98 IOWA LAW REVIEW 863, 865 (2013).

<sup>27</sup> European Commission, Energy 2020 — A Strategy for Competitive, Sustainable and Secure Energy, COM(2010) 639 final, of November 10, 2010, 9.

<sup>28</sup> Gerard Marata et al., Renewable Energy Incentives in the United States and Spain: Different Paths — Same Destination?, 28(4) JOURNAL OF ENERGY AND NATURAL RESOURCES LAW 481, 499 (2010).

<sup>29</sup> Anatole Boute, Combating Climate Change Through Investment Arbitration, 35 FORDHAM INTERNATIONAL LAW JOURNAL 613, 615 (2012).

<sup>30</sup> Jorge E. Viñuales, *Foreign Investment and the Environment in International Law: The Current State of Play*, in RESEARCH HANDBOOK ON ENVIRONMENTAL AND INVESTMENT LAW (Kate Miles ed., forthcoming).

<sup>31</sup> The original award (in Spanish) and an English translation (by MENA Chambers) are available at <http://www.italaw.com/cases/2082>. For an analysis of the award see Björn Arp, *Charanne B.V. v. Spain*, 110(2) AMERICAN JOURNAL OF INTERNATIONAL LAW 327 (2016) and Kim Talus, *Float Like a Butterfly, Sting Like a Bee: Judicial Challenges to Renewable-Energy Support Schemes in Europe*, 6 CLIMATE LAW 250 (2016).



balance the expectations of investors against the right of states to intervene in the public interest and adjust regulatory structures according to the specific circumstances that surround those cases. As divergent interpretations persist about when the investors' expectations deserve protection under the standards of investor protection, any evaluation will be deeply dependent upon the specific circumstances and facts of each particular case.<sup>32</sup> The approach of different international investment arbitrators to similar issues can vary considerably, creating a degree of uncertainty regarding the outcome of international investment disputes.<sup>33</sup> This lack of certainty raises the question of the necessity to create a specific investment regime for low-carbon investments.

#### *IV. The possible role of the UNCITRAL in developing international energy investment law*

The United Nations Commission on International Trade Law (UNCITRAL), established in 1966, serves as the core legal body of the United Nations system in the field of International Trade Law.<sup>34</sup> It is a 'specialized quasi-legislative commission'<sup>35</sup>, a 'transnational quasi-legislature of the world'<sup>36</sup> with a mandate to 'further the progressive harmonization and modernization of the law of international trade by preparing and promoting the use and adoption of legislative and non-legislative instruments in a number of key areas of commercial law.'<sup>37</sup> Over the past half a decade, UNCITRAL has international legal instruments on many areas of procedural and substantive law including dispute resolution, international contract practices, transport, insolvency, electronic commerce, international payments, secured transactions, procurement and sale of goods.<sup>38</sup>

The breadth of topics that UNCITRAL addresses has grown enormously since its creation.<sup>39</sup> While the incursion of the UNCITRAL into the realm of investment law is recent, its first products in this area — the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (2014)<sup>40</sup> and the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (2014)<sup>41</sup> are noteworthy contributions that signal an increasing engagement with the tensions and quandaries surrounding this field of international economic law.

The current wave of disputes in the field of renewable energy investments signals a failure by governments in adjusting their regulatory structures without destabilizing the market for renewable energies. Regardless of the final outcome of these disputes, they indicate a significant level of conflict between host states and investors. Well-designed economic support schemes are in the best interest of both governments and investors, because the alternative is an explosion of disputes where everyone loses except the arbitration industry.<sup>42</sup> Governments should factor in some flexibility into the regulatory structure so as

<sup>32</sup> Peter Cameron, Stability of Contract in the International Energy Industry, 27 JOURNAL OF ENERGY AND NATURAL RESOURCES LAW 305, 312-313 (2009).

<sup>33</sup> Condon & Sinha, The Role of Climate Change in Global Economic Governance 93.

<sup>34</sup> José Faria, The Relationship between Formulating Agencies in International Legal Harmonization: Competition, Cooperation, or Peaceful Coexistence? A Few Remarks on the Experience of UNCITRAL, 51 LOYOLA LAW REVIEW 253, 255 (2005); UNCITRAL, A Guide to UNCITRAL. Basic facts about the United Nations Commission on International Trade Law, available at <http://www.uncitral.org/pdf/english/texts/general/12-57491-Guide-to-UNCITRAL-e.pdf> 1 (last visited October 26, 2016); David Stewart, What Does International Law have to do with International Development?, 42 DENVER JOURNAL OF INTERNATIONAL LAW & POLICY 321, 327-328 (2014).

<sup>35</sup> Katherine Lynch, THE FORCES OF ECONOMIC GLOBALIZATION: CHALLENGES TO THE REGIME OF INTERNATIONAL COMMERCIAL ARBITRATION 209 (2003).

<sup>36</sup> Terence Halliday, Josh Pacewicz & Susan Block-Lieb, Who Governs? Delegations and Delegates in Global Trade Lawmaking, 7 REGULATION & GOVERNANCE 279, 280 (2013).

<sup>37</sup> UNCITRAL, A Guide to UNCITRAL 1.

<sup>38</sup> Ibid.

<sup>39</sup> Halliday, Pacewicz & Block-Lieb, Who Governs? 283; Edward Cohen, Normative Modelling for Global Economic Governance: The case of the United Nations Commission on International Trade Law (UNCITRAL), 36(2) BROOKLYN JOURNAL OF INTERNATIONAL LAW 567, 581 (2011).

<sup>40</sup> Available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/2014Transparency.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency.html).

<sup>41</sup> Available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/2014Transparency\\_Convention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency_Convention.html).

<sup>42</sup> Kyla Tienhaara, Does the Green Economy Need Investor-State Dispute Settlement?. Investment Treaty News,

to eliminate the risk of legitimate policy decisions giving rise to legal disputes, while at the same time providing adequate assurances to investors.<sup>43</sup> Policymakers need to design economic support schemes that are flexible enough to accommodate changes in the market without disrupting the stability of the regime itself.

Countries need to adopt a holistic approach to renewable energy policymaking so as to avoid possible clashes between different legal frameworks. Legal instruments, international investment law in particular, can help to mobilize the huge investments required to transform the energy sector to cleaner forms of generation. The challenge is to shape national policies in ways that do not breach the rights of foreign investors under international investment agreements. This can only be achieved if host states are truly aware of the scope of their obligations to foreign investors when they design and implement their renewable energy policies.<sup>44</sup> This requires a clear understanding of the disciplines of international investment law and how they may limit or impact upon national regulation.

UNCITRAL is in a privileged position to assist States in reforming and improving the legal frameworks applicable to investments in the renewable energy field. The Commission has been characterized as an ‘epistemic community’ or ‘group of knowledge-based experts’.<sup>45</sup> Like other specialized agencies of the United Nations, the Commission exhibits an increased ‘professionalization’ and ‘bureaucratization’ with an emphasis on technical concerns and responsibilities.<sup>46</sup> In designing new policies or adjusting existing ones, governments need to take into account that the legal framework that supports renewable energy investment is not confined to national regulations. The legal obligations borne by states towards investors encompass obligations in domestic law (contract and administrative law) but also in international law, namely international investment law. The challenge for governments is to strike a balance between regulation that discourages foreign investment and foreign investment protection that discourages regulation.<sup>47</sup> The wealth of knowledge acquired by the UNCITRAL over the years might be particularly useful in raising to this challenging task.

Regardless of the final outcome of the pending disputes, it is important to ensure that bridges between states and investors are not burned. The transition to a low-carbon model of development requires long-term cooperation between parties. Countries will continue to strive to design and implement energy policies that allow them to face climate change. Investors are essential partners in this process, and governments need to be able to encourage them to make their contribution in future ventures. The work model followed by the UNCITRAL is particularly apt to stimulate this inclusive type of debate. The UNCITRAL has been labelled by some scholars as an ‘inclusive body’<sup>48</sup> or a ‘site’ for ‘normative modelling’ through which legal norms, principles, and standards for the global political economy are articulated.<sup>49</sup> In addition to its sixty Member States,<sup>50</sup> UNCITRAL also invites as observers other Member States of the United Nations, as well as international and regional organizations (both intergovernmental and non-governmental) involved in shaping the legal frameworks of national and global commerce and investment.<sup>51</sup> Observers may participate

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November 15, 2015, available at <https://www.iisd.org/itn/2015/11/28/does-the-green-economy-need-investor-state-dispute-settlement/> (last accessed October 26, 2016).

<sup>43</sup> Vyoma Jha, Trends in Investor Claims Over Feed-in Tariffs for Renewable Energy, *Investment Treaty News*, 19 July 2012, available at <https://www.iisd.org/itn/2012/07/19/trends-in-investor-claims-over-feed-in-tariffs-for-renewable-energy> (last visited October 26, 2016).

<sup>44</sup> Condon & Sinha, *The Role of Climate Change in Global Economic Governance* 93.

<sup>45</sup> Lynch, *The Forces of Economic Globalization* 212.

<sup>46</sup> Katherine Lynch, *THE FORCES OF ECONOMIC GLOBALIZATION: CHALLENGES TO THE REGIME OF INTERNATIONAL COMMERCIAL ARBITRATION* 212, fn 236 (2003).

<sup>47</sup> Condon & Sinha, *The Role of Climate Change in Global Economic Governance* 93.

<sup>48</sup> Claire Kelly, Institutional Alliances and Derivative Legitimacy, 29 *MICHIGAN JOURNAL OF INTERNATIONAL LAW* 605, 615 (2008).

<sup>49</sup> Cohen, *Normative Modelling for Global Economic Governance* 568.

<sup>50</sup> See UNCITRAL, *Origin, Mandate and Composition of UNCITRAL*, available at <http://www.uncitral.org/uncitral/en/about/origin.html>.

<sup>51</sup> Faria, *The Relationship between Formulating Agencies in International Legal Harmonization* 262; Cohen, *Normative Modelling for Global Economic Governance* 568; Spiros Bazinas, *Harmonisation of International and Regional Trade Law: the UNCITRAL Experience*, 8 *UNIFORM LAW REVIEW* 53, 55 (2003).

in discussions to the same extent as members. By tradition, decisions taken by UNCITRAL and its working groups reconcile the different positions represented by its members and other participants by consensus rather than by vote.<sup>52</sup> Honnold refers to UNCITRAL as a ‘mix of academic specialists in commercial and comparative law, practicing lawyers, and members of government ministries with years of experience in international lawmaking’ with an acknowledged pragmatic approach.<sup>53</sup> The inclusion of a broad array of actors including states, corporate and industry representatives, legal experts and professionals, and other public and private international organizations allows the UNCITRAL to, despite its budgetary constraints, mobilize substantial know how and expertise. In the words of Halliday, Block-Lieb and Carruthers, ‘[t]here is little point in developing a global standard if the interest groups most affected by it will reject it on arrival, or if the experts who practice around the standard find it technically deficient’.<sup>54</sup> Such situations can lead to ‘actor mismatch’, a situation where national or industry actors are missing from the international text-making enterprise, and when local actors are missing from national lawmaking.<sup>55</sup>

This collaborative model also has the advantage of allowing for the coordination of the activities of organizations active in the field of international trade law. This helps to avoid duplication of efforts and to promote efficiency, consistency, and coherence in the unification and harmonization of international law.<sup>56</sup> The Energy Charter Secretariat has been discussing the benefits of a non-binding declaration and/or an interpretative note on the promotion of low-carbon investments. It is argued that such a statement would improve legal certainty in the application of the ECT, reducing the normative and political risks and investment related disputes.<sup>57</sup> Moreover, a clear political statement on low-carbon investments by the Energy Charter Conference would send an important signal to the international community and to investors on its commitment to sustainable development and climate change mitigation. The overall objective being the protection and balance the interests of ECT members and of international investors.<sup>58</sup> Greater policy coordination between the European Union and its member states is also needed.<sup>59</sup> The European Commission is currently working to devise a European policy on renewable energy promotion. In this regard, the design of support schemes is of paramount importance. While economic support mechanisms have demonstrated important successes, they have also evidenced a number of policy failures.<sup>60</sup>

The UNCITRAL is a ‘quasi governmental norm-creating forum’,<sup>61</sup> but is not alone in crafting global governance norms. It should therefore cooperate and collaborate with other leading organizations such as the Energy Charter Secretariat, the European Union, or the World Trade Organization in furthering a modern legal framework for foreign investments in renewable energies. These and other ‘formulating agencies’ should take part in this debate so as to prevent inconsistencies and contradictions between different rules and standards regulating global investment flows. This ‘inclusive process’,<sup>62</sup> involving a variety of participants, including member States of UNCITRAL, non-member States, and invited intergovernmental and non-governmental organizations, is part of the UNCITRAL’s ADN and is vital for distilling the best international practices, promoting consensus-building, and crafting a coherent, efficient legal framework.

<sup>52</sup> Faria, *The Relationship between Formulating Agencies in International Legal Harmonization* 263.

<sup>53</sup> John Honnold, *UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION* 7 (3<sup>rd</sup> ed, 1999).

<sup>54</sup> Terence Halliday, Susan Block-Lieb & Bruce Carruthers, *Rhetorical Legitimation: Global Scripts as Strategic Devices of International Organizations*, 8 *SOCIO-ECONOMIC REVIEW* 77, 81 (2010).

<sup>55</sup> Terence Halliday & Susan Block-Lieb, *Global Duellists: The Recursive Politics of the Text in International Trade Law*, in *SOCIO-LEGAL APPROACHES TO INTERNATIONAL ECONOMIC LAW: TEXT, CONTEXT, SUBTEXT* 77, 93 (Amanda Perry-Kessaris ed., 2013).

<sup>56</sup> Faria, *The Relationship between Formulating Agencies in International Legal Harmonization* 264.

<sup>57</sup> See Energy Charter Secretariat, *Energy Charter 2013 Annual Report* 25-26, available at [http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR\\_2013\\_en.pdf](http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2013_en.pdf) (last accessed October 26, 2016); Energy Charter Secretariat, *Energy Charter 2014 Annual Report* 19, available at [http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR\\_2014\\_en.pdf](http://www.energycharter.org/fileadmin/DocumentsMedia/AR/AR_2014_en.pdf) (last accessed October 26, 2016).

<sup>58</sup> Energy Charter Secretariat, *Energy Charter 2013 Annual Report* 26.

<sup>59</sup> Daniel Behn et al., *Promoting Renewable Energy in the EU: Shifting Trends in Member State Policy Space* 8-11, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2704333](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2704333), 6 (last visited October 26, 2016).

<sup>60</sup> *Ibid.*, 2.

<sup>61</sup> Kelly, *Institutional Alliances and Derivative Legitimacy* 610.

<sup>62</sup> See UNCITRAL, *A Guide to UNCITRAL* 1.

It is the combination of the process of participation and consensus-building that leads to the wide acceptability of UNCITRAL texts.<sup>63</sup>

The UNCITRAL should also coordinate its activities with other United Nations agencies, namely the United Nations Conference on Trade and Development (UNCTAD)<sup>64</sup> and the United Nations Environment Programme (UNEP).<sup>65</sup> The former performs an important role in gathering and dissemination information in the field of international investment and international investment law.<sup>66</sup> Each year UNCTAD publishes the ‘World Investment Reports’ outlining trends in global foreign direct investment and providing in-depth analysis into trends in investment treaty practice.<sup>67</sup> The 2015 ‘Investment Policy Framework for Sustainable Development’,<sup>68</sup> provides guidance for policymakers in the evolution towards a new generation of investment policies, offering operational guidelines or action menus for national investment policies, guidance for the design and use of international investment agreements, and an action menu for the promotion of investment in sectors related to the sustainable development goals. This document serves as an important reference for policymakers in formulating national and international investment policies that are more suited to the particularities of renewable energy markets. It contains important suggestions on how to design investment incentive schemes for sustainable development,<sup>69</sup> for example, that ‘[i]nvestment incentives should (...) not become permanent; the supported project must have the potential to become self-sustainable over time — something that may be difficult to achieve in some sectors. This underlines the importance of monitoring the actual effects of investment incentives on sustainable development, including the possibility of their withdrawal if the impact proves unsatisfactory.’<sup>70</sup>

The UNEP, on the other hand, coordinates the environmental activities of the United Nations. It aims at serving as the ‘leading global environmental authority that sets the global environmental agenda, promotes the coherent implementation of the environmental dimension of sustainable development within the United Nations system and serves as an authoritative advocate for the global environment.’<sup>71</sup>

The numerous claims over changes in economic support mechanisms that have surfaced in the past few years provide evidence that states need to rethink and reshape their renewable energy policies. The determination of what is reasonable for the investor to expect is important for any reform of legal frameworks. Shifts in both policy and the development of countries make this determination different from country to country.<sup>72</sup> The creation of efficient and sustainable markets for renewable sources of energy is a tremendous financial and legal challenge. This endeavour can only be achieved through a thorough knowledge of the functioning and possible implications of the economic mechanisms and legal frameworks that underpin foreign investments in the renewable energy market. While it is not the only global formulating agency, the work of the UNCITRAL gains added credibility and legitimacy from its perceived representatives and its institutional aura as a United Nations organ.<sup>73</sup> In crafting modern legal instruments

<sup>63</sup> Caroline Nicholas, *Negotiations and the Development of International Standards in Public Procurement: Let the Best Team Win?* 7(1) *TRADE LAW & DEVELOPMENT* 64, 80 (2015); Julia Salasky & Corinne Montineri, *UN Commission on International Trade Law and Multilateral Rule-making: Consensus, Sovereignty and the Role of International Organizations in the Preparation of the UNCITRAL Rules on Transparency*, in *RESHAPING THE INVESTOR-STATE DISPUTE SETTLEMENT SYSTEM. JOURNEYS FOR THE 21<sup>ST</sup> CENTURY* 584, 587 ff (Jean E. Kalicki & Anna Joubin-Bret eds., 2015).

<sup>64</sup> See <http://unctad.org/en/Pages/Home.aspx>.

<sup>65</sup> See <http://www.unep.org/>.

<sup>66</sup> See Investment Policy Hub (<http://investmentpolicyhub.unctad.org/>) a comprehensive and free online database of all International Investment Agreements and many investor-state dispute settlement cases.

<sup>67</sup> See <http://www.worldinvestmentreport.org>.

<sup>68</sup> See [http://investmentpolicyhub.unctad.org/Upload/Documents/INVESTMENT%20POLICY%20FRAMEWORK%202015%20WEB\\_VERSION.pdf](http://investmentpolicyhub.unctad.org/Upload/Documents/INVESTMENT%20POLICY%20FRAMEWORK%202015%20WEB_VERSION.pdf).

<sup>69</sup> *Ibid.*, 124 ff.

<sup>70</sup> *Ibid.*, 127.

<sup>71</sup> See <http://www.unep.org/about>.

<sup>72</sup> Åsa Romson, *International Investment Law and the Environment*, in *SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW* 37, 40 (Marie-Claire Segger et al. eds, 2011).

<sup>73</sup> Gerard McCormack, *Secured Transactions Law Reform, UNCITRAL and the Export of Foreign Legal Models*, in *AVAILABILITY OF CREDIT AND SECURED TRANSACTIONS IN A TIME OF CRISIS* 33, 34 (N. Orkun

to address these issues, the Commission need to adopt democratic and legitimate rule-making processes that ensure fair representation and participation of all the interests at stake in the development process.<sup>74</sup> The Commission should invite other international formulating agencies and international organizations to co-operate closely on these issues so as to avoid duplication of efforts and inconsistency between policies and rules.

The work of the UNCITRAL typically takes the form of conventions, model laws, legislative guides, or model provisions.<sup>75</sup> The use of varied strategies allows UNCITRAL the flexibility to approach particular areas of law taking into account its specificities and reflect the different degrees of consensus that can be reached among all intervening parties. Conventions are, naturally, difficult to negotiate. It seems more realistic, therefore, to adopt alternative tools such as the elaboration of a legislative guide that could provide valuable technical information to promote and revise bilateral or multilateral investment treaties and national investment laws. Legislative guides allow for greater flexibility by accommodating dissent and national particularities and including more detailed background material for the guidance of national legislators.<sup>76</sup> A legislative guide on international investments in the renewable energy market should focus on reducing inconsistent or overly broad interpretations of investment disciplines by offering model provisions that incorporate more precise language and are adjusted to the technical intricacies of this type of investments. The guide should circulate among key actors so as to, hopefully, shape legal reform efforts in more indirect but effective ways than formal conventions.<sup>77</sup>

It should also be recognized that UNCITRAL, like other elements of the United Nations, faces budget pressures, so it is important that it focuses its efforts and resources in priority projects.<sup>78</sup> In considering what topics should be added to its work program, the Commission takes into account factors such as global significance, special interest to developing countries, developments in technology, and changing trends in commercial practice.<sup>79</sup> For the reasons discussed in the second and third sections of this paper, UNCITRAL could, and should, devote its attention to the creation of a modern international legal framework that supports and promotes investments in the renewable energy field, protecting the legitimate interests of investors while retaining the regulatory space of host states. The UNCITRAL has been recognized as one of the most practical and productive organs in the United Nations constellation.<sup>80</sup> Its legislative products are highly influential in shaping the law of global commerce.<sup>81</sup>

UNCITRAL has developed sophisticated means of integrating widely diverse interests, of obtaining broadly inclusive representation, of establishing expert authority.<sup>82</sup> This paper has argued that the UNCITRAL is in a privileged position to lead an effort — along with other international organizations, public and private stakeholders — to conduct a thorough analysis of the challenges raised by the growing interaction between international investment treaties and national legal frameworks that regulate economic incentives in the renewable energy field and devise a legislative text offering effective solutions.

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Akseli ed., 2013).

<sup>74</sup> Jan Wouters & Nicolas Hachez, *The Institutionalization of Investment Arbitration and Sustainable Development*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 611, 626 (Marie-Claire Cordonier Segger et al. eds., 2011).

<sup>75</sup> UNCITRAL, A Guide to UNCITRAL 13-18.

<sup>76</sup> Megan Donaldson & Benedict Kingsbury, Ersatz Normativity or Public Law in Global Governance: The Hard Case of International Prescriptions for National Infrastructure Regulation, 14(1) CHICAGO JOURNAL OF INTERNATIONAL LAW 1, 12(2013).

<sup>77</sup> Edward Cohen, Normative Modelling for Global Economic Governance: The case of the United Nations Commission on International Trade Law (UNCITRAL), 36(2) BROOKLYN JOURNAL OF INTERNATIONAL LAW 567, 582 (2011).

<sup>78</sup> Keith Loken, A New Global Initiative on Contract Law in UNCITRAL: Right Project, Right Forum?, 58 VILLANOVA LAW REVIEW 509, 519 (2013).

<sup>79</sup> Faria, The Relationship between Formulating Agencies in International Legal Harmonization 268.

<sup>80</sup> Loken, A New Global Initiative on Contract Law in UNCITRAL 519.

<sup>81</sup> Cohen, Normative Modelling for Global Economic Governance 567-568.

<sup>82</sup> Terence Halliday, Susan Block-Lieb & Bruce Carruthers, *Attaining the Global Standard*, in BANKRUPT: GLOBAL LAWMAKING AND SYSTEMIC FINANCIAL CRISIS 122, 124 (Terence Halliday & Bruce Carruthers eds., 2009).

*The Reduction of the Legal Obstacles Faced by MSMEs in the  
Footsteps of the Previous Attempts at Harmonizing Company Law:  
Will UNCITRAL Reinvent the Role of Harmonization in Company Law?*

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*I. Introduction*

Since 2014, the UNCITRAL Working Group I has been elaborating a proposal aiming at harmonizing the legal framework for MSMEs (micro, small and medium enterprises). This initiative, which is the first attempt at harmonizing company law at the global level, displays some distinctive features that apparently restrain its scope. More precisely, Working Group I aims only at creating tools to facilitate business registration and allow small businesses to grow and succeed in developing nations. In addition, in the ongoing discussions, emphasis has been placed on the possibility of creating a “delinked” legislation, so that the impact on the national company law currently in force in any legal system would be minimal. Yet current efforts are focused on elements that are essential to any company law, such as limited liability, legal personality, party autonomy, object clauses and capital requirements. Moreover, the proposal under discussion addresses the different aspects of any national company law, including business registration, internal organization, directors, contributions, distributions, transfers of rights, conversions, restructuring, dissolution and winding-up.

This paper argues that, if this initiative is to succeed, it will be impossible to consider the proposed rules as legislation that is independent from the national company laws in which they will be implemented. This process will inevitably lead to broader harmonization of company law. Since the initiative under discussion at Working Group I has the potential to influence company law more broadly, special attention should be given to the existing regional attempts at harmonizing legislation in this field. The experiences of the European Union, OHADA, the Caribbean countries and, more recently, OAS may provide useful guidance to Working Group I on the strategies that succeeded at creating a viable harmonized company law framework — and those that failed.

This paper is organized as follows: Part II provides a short outline on the UNCITRAL initiative on MSMEs currently under discussion at Working Group I and explains the general implications of this project for national company law. Part III discusses the regional strategies to harmonize company law. This part also briefly discusses the different harmonization techniques that have been adopted to achieve this goal. Part IV discusses the implications of the project under discussion at Working Group I and recommends relying on previous experiences to move forward in the harmonization of company law. Part V concludes this paper.

*II. The UNCITRAL Initiative on MSMEs and its Implications for National Company Law*

*A. The UNCITRAL Initiative on MSMEs*

*1. The Goals of the UNCITRAL Initiative on MSMEs*

In these few pages, it is not necessary to investigate the details of the initiative of UNCITRAL on MSMEs. We would simply note that work in this area began recently and that Working Group I started discussing this topic in early 2014, after having received a mandate by UNCITRAL in 2013.

The idea of taking action in this field may be traced back to a colloquium on microfinance, which was held in Vienna in January 2013 and addressed various topics. A review of the materials presented there<sup>1</sup>

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<sup>1</sup> For additional details on this colloquium on microfinance, see <http://www.uncitral.org/uncitral/en/commission/colloquia/microfinance-2013-papers.html>, last visited on December 20, 2016.

gives interesting indications for the roots of this initiative: several presentations covered the creation of an enabling environment for micro-businesses, while others dealt with the facilitation of incorporation and registration of potential micro-borrowers. The colloquium saw several interventions from Colombian speakers, in particular from the Superintendencia de Sociedades; special attention was given to the Colombian SAS (Simplified Stock Corporation), a hybrid legal entity inspired by both the US Limited Liability Company and the French Société par actions simplifiée.<sup>2</sup>

This digression on the 2013 colloquium is useful to understand the drivers of the UNCITRAL initiative on MSMEs that influenced the early discussions at Working Group I. In fact, the project revolved around a few very different ideas: (a) providing a tool for micro-businesses to better carry out their activities, (b) facilitating the incorporation and registration of micro-businesses to make them bankable vis-à-vis potential lenders, and (c) introducing a simplified legal form to carry out business.<sup>3</sup>

With regard to the first idea, this is a goal that could have been achieved following various strategies: one approach would be to introduce new legal entities designed for micro-businesses, a solution that would have mimicked the Colombian experience. Other potential strategies were not directly related to company law, but were inspired by other tools existing in some jurisdictions to facilitate business activities. More precisely, Working Group I examined the French EIRL (Entreprise individuelle à responsabilité limitée) and the Italian Contractual Network (Contratto di rete).

With regard to the idea of facilitating the incorporation and registration of micro-businesses, the principal goal was the creation of a legal framework to facilitate micro-borrowing. In that perspective, the UNCITRAL initiative is also a logical evolution of the debate on secured transactions: in order to finance a business, even the most advanced framework on secured transactions works only if the pool of assets on which interests are created is well defined and easy to monitor. However, the confusion between personal and business assets increases lenders' monitoring costs, which in turn makes borrowers more difficult to finance. To address this problem, one solution is that of facilitating the creation of micro-entities to decrease lenders' monitoring costs. Certainly, the creation of separate pools of assets makes it easier for lenders to finance micro-businesses. However, to encourage borrowers to create legal entities, the separation of pool of assets should also entail the limited liability of borrowers, so as to give them an incentive to incorporate.<sup>4</sup> Therefore, to facilitate lending, it is important to ensure the separation between personal and business assets, something that may be achieved by incorporating legal persons with limited liability. Thus, it is not surprising that the Colombian approach prevailed over the French and the Italian ones in the initial meetings of Working Group I, since, to the advantage of both lenders and borrowers, it allowed a more intuitive and manageable separation of personal and business assets.

With regard to the last idea that influenced the early development of the initiative on MSMEs, i.e. the introduction of a simplified legal entity to carry out business activities, in its first sessions, Working Group I discussed at length the possibility of adopting a model law to enable the creation of these entities. It is important to stress that the idea of introducing new legal forms is not exclusively related to the creation of a friendly environment for micro-businesses. In fact, the simplification of national company law has been considered not only for micro-businesses, but also for small and medium-sized enterprises. Hence it is important to highlight that simplification is a goal of the UNCITRAL initiative that is partially different from that of favouring the growth of micro-businesses. Interestingly, also to achieve that goal, inspiration was taken from the Colombian experience with the SAS, since it appeared to be a successful model for that purpose as well.

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<sup>2</sup> Therefore, it is not surprising that the discussions on the Colombian experience with simplified legal entities marked the initial discussions on the UNCITRAL initiative on MSMEs.

<sup>3</sup> In addition to these three ideas, the initiative has also been influenced by the research of the World Bank, see in particular, Rahman et al., *Reforming Business Registration: A Toolkit for Practitioners* (2013), available at <http://documents.worldbank.org/curated/en/577211468155378578/Reforming-business-registration-a-toolkit-for-the-practitioners>, last visited on December 20, 2016.

<sup>4</sup> For an economic analysis of limited liability, see Bainbridge-Henderson, *Limited Liability. A Legal and Economic Analysis*, Elgar, Cheltenham — Northampton, 2016, 44 ff.

## 2. *The Mandate of the Commission*

Notwithstanding the drivers that gave the initial impulse to the UNCITRAL initiative on MSMEs, it is also important to highlight the terms of the mandate the Commission gave to Working Group I. On that point, it is interesting to note that, as indicated in the provisional agenda of the meetings of Working Group I, the focus was on the life cycle of businesses, particularly in relation to micro- and small-sized enterprises. In addition, it was clearly suggested that:

“the Working Group could begin with the facilitation of simplified business incorporation and registration, following which it could continue with other matters, such as those discussed at the 2013 colloquium, in order to create an enabling legal environment for this type of business activity”.<sup>5</sup>

Furthermore, the emphasis on business registration was strengthened in the UNCITRAL session held in 2014, which:

“reaffirmed the mandate of the Working Group, relative to reducing the legal obstacles faced by MSMEs throughout their life cycle, in particular those in developing economies beginning with a focus on the legal questions surrounding the simplification of incorporation”.<sup>6</sup>

In conclusion, the mandate given by UNCITRAL is in line with the ideas that initially inspired the initiative on MSMEs. It is nevertheless worth noting that the problem of business registration received special attention. On the one hand, this seems more consistent with the goal of creating a tool that micro-businesses could use to carry out their activities, and with that of making these entities bankable vis-à-vis potential lenders. On the other hand, the mandate does not emphasize the goal of simplifying company law.

## 3. *The UNCITRAL Initiative on MSMEs: Current Status*

So far, Working Group I has discussed the initiative on MSMEs in six sessions. Over the course of these meetings, it became evident that the registration of legal entities was a distinct issue from that of the creation of a harmonized framework for MSMEs.

Another important issue discussed in the first sessions of Working Group I was the nature of the instrument to be prepared: more precisely, while for the registration of businesses, the texts discussed by Working Group I always took the form of a legislative guide, the proposed introduction of a harmonized legal framework for simplified business entities was, until recently, discussed in the form of a draft model law.

In light of these early discussions, it was finally decided to separate the initiative concerning business registration from that regarding the creation of simplified legal entities. Although both topics will continue to be on the agenda of Working Group I, the initiative on MSMEs will take two different paths, and two different documents will be prepared in view of achieving the goals pursued by Working Group I.

Importantly, a tentative solution was also found for the problem of what kind of instrument should be prepared. At present, for both the initiative on business registration and that on the creation of simplified legal entities, the decision of adopting a legislative guide prevailed over that of introducing a model law. This approach of Working Group I also received the support of UNCITRAL:

“The Commission also noted the decision of the Working Group to prepare a legislative guide on each of those topics, which would support an overarching introductory framework generally explaining the MSME work and possibly accommodating future instruments on MSMEs that might be adopted by

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<sup>5</sup> See *A/CN.9/WG.I/WP.97 — Annotated provisional*, available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1MSME.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1MSME.html), last visited on December 20, 2016, para. 11.

<sup>6</sup> *Ibid.*, para. 14.



the Commission. After discussion, the Commission commended the Working Group on the progress that was being made on the two topics”.<sup>7</sup>

At present, Working Group I has started examining the draft legislative guide on the provisionally called “UNCITRAL Limited Liability Organization” (or UNLLO) and is planning, in the next sessions, to continue its efforts to prepare a legislative guide on business registration.

#### *B. Implications of the UNCITRAL Initiative on MSMEs for National Company Law*

The initiative on MSMEs currently being discussed by Working Group I may have repercussions that extend beyond its intended goals. Although the proposals on business registration and simplified legal entities are addressed only to MSMEs, their adoption by UN Member States could have important implications for national company law.

##### *1. The Role of Business Registers in Business Registration*

Starting with the initiative on business registration, one of the most relevant issues that remains unsolved is that of the value that may be attached to the information available in business registers. In general, Working Group I has discussed two different approaches: the notification approach, which is frequent in common law jurisdictions, and the verification approach, which is prevalent in civil law countries. Under the notification approach, the information made available by business registers is not subject to prior verifications; therefore, the data collected may be unreliable, and the persons that made the filings usually cannot invoke such data in their dealings with third parties. The advantage of this system lies in the speed of notifications and the fact that no infrastructure is needed to check the accuracy of information.

The verification system requires that information filed with business registers be verified by business registers, courts or legal professionals before it is entered in the register and made available to the public. The advantage of this system lies in the high degree of certainty that may be attached to information made available to third parties. This high degree of certainty may result in attaching special value to the information included in business registers, such that even the persons that made the filings may invoke information in the register in their dealings with third parties.

Both these approaches are reflected in the discussions of Working Group I on the registration of business entities. The principal issue on this point concerns the creation of a separate legal entity resulting from the registration of a business. If the registration of a legal entity triggers the creation of a legal person, it seems incongruous to grant this privilege as a result of a potentially erroneous notification made by any individual operating in a notification system. To counter this criticism, it may be responded that the ex-ante controls surrounding the incorporation of legal entities in verification systems appear outdated and represent a relic of the antiquated approach that required governmental authorization for the creation of legal entities. This last argument, however, is not particularly convincing, since the controls that are performed in the majority of the countries that adopt a verification system do not represent a serious barrier per se to the incorporation of legal entities, and the positive externalities that derive from the existence of a reliable public register may easily outweigh the cost associated with ex-ante controls.<sup>8</sup>

This contentious issue is a key aspect of the attempt at creating a harmonized framework for the registration of business entities, especially if a law provides that legal entities come into existence only when registered in business registers. Regardless of the solution that will be adopted, the potential implications for national company law of the choice between a notification or a verification system are evident, since, arguably, it will be impractical for a legislature to attach a different value to the information concerning different types of limited liability entities enrolled in the same business register.

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<sup>7</sup> Ibid., para. 20.

<sup>8</sup> On these issues, cf. Arruñada, *Institutional Foundations of Impersonal Exchange*, Chicago University Press, Chicago, 2012, 161 ff.

In fact, we cannot rule out the possibility that, in the end, no solution will be taken to solve this problem, relying on the idea that all business registers provide — at least — some information, and that what really distinguishes them is the level of reliability of that information. A solution of this type will result only in a black letter law harmonization that will paper over the actual difficulties of achieving a compromise by allowing UN Member States to adopt whichever approach they prefer.

In conclusion, the problem of the prior verification and legal value of the information made available in business registers has implications that extend beyond the limited scope of an initiative addressed to MSMEs in developing countries. In fact, this issue could even influence a jurisdiction's general approach to the value of the information filed in business registers.

## 2. *The Implications for National Company Law of the Adoption of a Simplified Framework for Legal Entities*

The part of the initiative on MSMEs devoted to the creation of a legal framework on simplified legal entities may raise problems that are as contentious as those on business registration. For example, the discussions on the recognition of limited liability and legal personality already gave Working Group I an opportunity to evaluate under what conditions veil-piercing doctrines may be applied. In addition, Working Group I considered other delicate issues, such as the possibility of recommending the introduction of unrestricted object clauses and the abolition of minimum capital requirements. More broadly, the draft legislative guide currently under discussion provides a detailed framework for all the essential elements of a company law statute, including the rules on formation, internal organization, directors, contributions, distributions, transfer of rights, conversion, restructuring, dissolution and winding-up.

Importantly, the draft legislative guide recommends delinking the statute that governs the UNLLO from the national company law of the country that adopts this instrument. Arguably delinking may facilitate negotiations within Working Group I and limit the repercussions on national company law of the introduction of a statute on simplified legal entities: a UNLLO statute could be enacted as standalone legislation that remains separate from national company law.

The idea of adding a new legal entity to those already available in a jurisdiction is not new: for example, the European Union in the past introduced legal entities as additional supranational legal forms. To some extent, the Regulation on the *Societas Europaea* (European Company), finally adopted in 2001,<sup>9</sup> may be understood as a tool that introduced a new company in addition to those already available in EU Member States.

However, other more recent initiatives that tried to follow a similar strategy, such as the *Societas Privata Europaea* and the *Societas Unius Personae*, have not been enacted even after long discussions. The experience of the European Union with these regional attempts at harmonizing company law is not particularly promising for the UNLLO: for example, examining the last of these initiatives, i.e. the *Societas Unius Personae*, when the European Union tried to adopt legislation on that legal entity, the reactions of the Member States were polarized and, in some comments, this initiative was labelled as a “wolf in sheep's clothing”,<sup>10</sup> or even a “Trojan horse”<sup>11</sup> that could have breached the walls of national company law.

Furthermore, even the initiatives of the European Union that were ultimately enacted, such as the *Societas Europaea*, only achieved partial harmonization, since they left unsettled many issues that, even today, remain governed by national law, so that the rules applicable to a European Company in a Member State are completely different from those applicable to the same legal entity in another Member State. In addition, even when the Regulation on the European Company addressed a specific topic, in some cases it

<sup>9</sup> The reference is to Reg. (EC) 2157/2001.

<sup>10</sup> Beurskens, „*Societas Unius Personae*” — *der Wolf im Schafspelz?* — *Der Vorschlag für eine Richtlinie über Gesellschaften mit beschränkter Haftung mit einem einzigen Gesellschafter*, GmbHRR (2014), 738.

<sup>11</sup> See, for example, Siems, *The Societas Unius Personae (SUP): a Trojan Horse?*, available at <http://www.siemslegal.blogspot.it/2014/04/the-societas-unius-personaesup-trojan.html>, last visited on October 20, 2016.

still failed to adopt a clear solution and just gave a set of options.<sup>12</sup> In other cases, just a compromise solution was adopted without solving the underlying issue.<sup>13</sup>

In conclusion, the idea of delinking the UNLLO legislative guide from national company law will not make it easier to reach a compromise on the key elements of this initiative. Certainly, from a drafting perspective, this approach makes it easier to create a single and coherent statute for simplified legal entities. However, the substantial nature of the problems that will be addressed by the legislative guide will and should be understood in view of the possible repercussions the solutions adopted will have on national company law. Therefore, it will be unwise to underestimate the potential implications of the UNLLO project for national law, which, as the first global attempt at harmonizing company law, will necessarily mark the path for any future global harmonization initiative in this field. From this perspective, a policy-based approach that states clear and well-defined policy goals and provides several legislative options to achieve them would be preferable to reaching an only apparent compromise on the wording of a legislative guide.<sup>14</sup>

### III. *The Harmonization of Company Law at the Regional Level*

The significance of the UNCITRAL initiative on MSMEs for company law is clearly visible in the fact that this project is the first attempt at harmonizing this field at the global level. However, Working Group I is not writing on a blank slate: previous harmonization projects resulted in the adoption of important pieces of legislation. A first historical example may be traced back to the efforts that led the countries that, at that time, formed the Deutscher Bund toward the adoption of the ADHGB (Allgemeines Deutsches Handelsgesetzbuch) in 1861. Similarly, the enactment in 1968 of the First Company Law Directive (Dir. 68/151/EEC) remains an important step in the harmonization of the company law of the Member States of the European Union. In the following pages, I provide an outline of some of the most relevant harmonization initiatives undertaken at the regional level in the domain of company law. More precisely, I discuss in particular the initiatives undertaken in the European Union, OHADA, the Caribbean countries and OAS.

#### A. *European Union*

The European Union is currently following three different approaches to harmonize company law, and a fourth strategy is under discussion among academics.<sup>15</sup> The first approach is the harmonization by approximation of company law. In short, this strategy aims at levelling the playing field with regard to the protections granted to shareholders and third parties, in view of facilitating the free movement of legal entities within the internal market.

The second strategy pursued by European authorities aims at the unification of company law. This approach resulted in the creation of some supranational legal forms, including the previously mentioned Regulation on the Societas Europaea. In its purest form, this strategy endeavours to create European legal entities that are independent from national company law, a goal that has not been completely achieved even with the Societas Europaea.<sup>16</sup>

The third strategy pursued by the European Union is that of encouraging the creation of regulatory competition between Member States. This approach is more recent, and it may be traced back to the *Centros*

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<sup>12</sup> One example of this optional approach may be found in the freedom companies enjoy to choose between a one-tier or a two-tier board structure.

<sup>13</sup> For example, this was the approach of the compromise to the problem of the choice between the real seat and the incorporation theory.

<sup>14</sup> See, for example, Wool, *Rethinking the Role of Uniformity in the Drafting of International Commercial Law: A Preliminary Proposal for the Development of a Policy-Based Unification Model*, 2 Unif. L. Rev. (1997), 46.

<sup>15</sup> For an overview of the different harmonization strategies of European company law see Grundmann — Glasow, *European Company Law*, Intersentia, Cambridge, 2012, 2<sup>nd</sup> ed., 53 ff.

<sup>16</sup> The statute of the European Company is not self-sufficient, and frequently, in order to fill the gaps, reference should be made to the national law.

decision of the ECJ of 1999.<sup>17</sup> While this strategy had some repercussions on the legislation of the Member States in certain domains, such as the minimum capital requirements of limited liability entities, it did not contribute to a more harmonized company law framework.<sup>18</sup>

Finally, the fourth approach currently under discussion by European academics is that of working on a model law, the so-called European Model Company Act (EMCA), whose first version was recently presented publicly. It is difficult to believe that the EMCA may be adopted in its entirety by any EU Member State, but this project is important because it has given rise to an active forum of discussion on several company law topics, and it may inspire some targeted reforms of national company law.<sup>19</sup>

The initiatives undertaken by the European Union in the domain of company law probably constitute the most elaborate and comprehensive harmonization project undertaken in this field, and this experience should be carefully evaluated by Working Group I to assess its virtues and limits. With specific regard to the UNCITRAL initiative on MSMEs, it is worth noting that the harmonization of incorporation procedures and the creation of a general framework for business registers were among the first topics addressed by the First Company Law Directive in 1968.

### B. OHADA

A second important experience in company law harmonization comes from OHADA. This experience is less multifaceted than the European endeavour, but more in-depth and more remarkable for its results. In 1997, OHADA adopted the “Acte uniforme relatif au droit des sociétés commerciales”, a comprehensive company law statute that pre-empted the national company law of all OHADA Member States. This initiative achieved the extraordinary result of introducing a uniform and directly applicable company law framework, with a unification that left little room for the intricacies that, for example, may be found in the European Union in the relationship between national and European law. This project considers all aspects of company law in detail, including that of the registration of legal entities.<sup>20</sup>

Remarkably, the project was also recently updated in 2014, and, among other things, this reform introduced a new simplified legal entity, the Société par actions simplifiée, inspired by the French experience. However, with the 2014 reform, the complete unification of company law was partially lost: currently, the amended “Acte uniforme” leaves OHADA Member States the freedom to opt out from the provisions of the Act on two points: the formalities surrounding the incorporation and the minimum capital requirements of limited liability companies.<sup>21</sup>

### C. Caribbean Countries

Another interesting experience in company law harmonization at the regional level may be found in the Caribbean countries. The harmonization process in this region started in 1971 within CARIFTA; afterwards, these efforts were taken over by the Caribbean Community (CARICOM). This project resulted in the publication of a Report and a model legislation. Afterwards, these efforts were followed by those of the Caribbean Law Institute. All these different initiatives deeply influenced the legislations of many Caribbean countries.<sup>22</sup> More recently, it is also worth mentioning an initiative of OHADAC, which, in 2014,

<sup>17</sup> ECJ, 9 March 1999, Case C-212/97, *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-1484.

<sup>18</sup> For example, the competition between Member States led to the lowering of capital requirements for European limited liability companies. However, Member States adopted different approaches to achieve that goal, so this process did not result in a harmonized framework on this issue.

<sup>19</sup> For a recent overview on this project, see the articles published in the second issue of 13 ECFR (2016).

<sup>20</sup> See Fénéon, *Droit des sociétés en Afrique [OHADA]*, LGDJ, Issy-les-Moulineaux, 2015, 4 ff.

<sup>21</sup> *Ibid.*, 9 ff.

<sup>22</sup> Including Barbados, Anguilla, Bahamas, Dominica, Guyana, Grenada, Jamaica, Montserrat, Saint Lucia, Saint Vincent, and Trinidad and Tobago. On the harmonization initiatives in the Caribbean see, for example, Burgess, *Commonwealth Caribbean Company Law*, Routledge, Abingdon, 2013, 11 ff.; Mangal, *An introduction to company law in the Commonwealth Caribbean*, Canoe Press, Barbados, 1995, 5 ff.

published a draft model law on commercial companies. This project adopts a different approach from previous Caribbean initiatives, which relied mainly on the common law legal tradition.

The attempts at harmonizing company law in the Caribbean region are interesting since they have taken a different path from that undertaken by the European Union or OHADA. Even without imposing the adoption of a specific legislation, these projects were able to influence the company law of many countries in the region. However, it has been argued that the results of this harmonization process did not bring “a high degree of uniformity ... even among [the countries] implementing reforms”.<sup>23</sup>

#### D. OAS

Another regional experience worth mentioning is that of OAS. At first, the efforts of this organization were aimed at the harmonization of private international law and resulted in the signing of two conventions: the Inter-American Convention on Conflicts of Laws Concerning Commercial Companies of 1979, and the Inter-American Convention on Personality and Capacity of Juridical Persons in Private International Law of 1984.

However, more recently, OAS started exploring new strategies, and, in 2012, a model law for the creation of a statute on a simplified stock corporation was presented to the Inter-American Juridical Committee. This initiative is deeply influenced by the Colombian experience with the SAS, and, to some extent, it has traits in common with the early works of Working Group I that, in its earlier sessions, considered a similar model law. However, this project has not yet been adopted by OAS, which last discussed it at the Committee on Juridical and Political Affairs, where, after a lively discussion, it was recommended “further study and analysis of the matter”.<sup>24</sup>

#### E. Other Harmonization Experiences

After this cursory analysis of the initiatives for company law harmonization that are relevant to the UNCITRAL initiative on MSMEs, it is also useful to mention some other experiences in this field. These attempts took place in single jurisdictions or at the regional level at different moments in the history of company law.

Examining the experiences that took place in a single country, it is worth mentioning the harmonization of cantonal law in Switzerland that, at the beginning of the 20<sup>th</sup> century, resulted in the adoption of the national codification of company law. Other interesting initiatives may be found in Canada with the Canada Business Corporations Act, and in the process that led to the enactment of the Australian Corporations Act 2001. With regard to the United States, an important example of soft law harmonization may be found in the process that led from the Uniform Business Corporation Act to the Revised Model Corporation Act in the twentieth century.

Finally, examining regional harmonization experiences, prominent examples of harmonization of company law may be found in the inter-Nordic legislative cooperation after World War II, in the important efforts pursued within the Commonwealth of Independent States, and in some initiatives recently undertaken by APEC.<sup>25</sup>

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<sup>23</sup> See, Goddard, *Convergence in Corporations Law-Towards a Facilitative Model*, 26 Victoria U. Wellington L. Rev. (1996), 191, 196.

<sup>24</sup> See CP/CAJP-3318/15, available at [scm.oas.org/doc\\_public/ENGLISH/HIST\\_15/CP34561E08.doc](http://scm.oas.org/doc_public/ENGLISH/HIST_15/CP34561E08.doc), last visited on December 20, 2016, 3.

<sup>25</sup> This last experience has been mentioned in relation with the UNCITRAL initiative on MSMEs; see, for example, Dennis — Pliego Ramos, *Creating an Enabling Legal Environment for Micro-, Small-, and Medium-Sized Enterprises: Simplified Incorporation and Registration*, 33 Ariz. J. Int'l & Comp L. (2016), 71, 77 ff.

#### *IV. Future Prospects for the UNCITRAL Initiative on MSMEs*

The previous pages illustrate the various forms that company law harmonization efforts have taken in the past. Certainly, the UNCITRAL has its own working method and the results of the discussions of Working Group I will follow that approach. In the case of the initiative on MSMEs, it appears that Working Group I's efforts could take the form of a legislative guide while, for the moment, the adoption of a model law seems less likely.

Given the work done so far, what is striking is that Working Group I was not particularly interested in the successful harmonization efforts carried out by regional organizations such as the European Union or OHADA, which together count for 45 UN Member States. Apparently, the strategy implemented by Working Group I displayed more characteristics in common with tentative initiatives such as the OAS Simplified Stock Corporation or the efforts of the APEC that achieved less meaningful results. This is obviously not to say that the first attempt at harmonizing company law at the global level should take the form of the legislations in force in the European Union or in OHADA. However, at the very least, more attention should be devoted to these experiences, since the different elements that are currently under consideration at UNCITRAL were considered at length in these previous harmonization initiatives.

While the initiative under discussion at UNCITRAL is focused on MSMEs, it would be limiting to consider it only within the framework of economic development. The initiative has the potential to influence the future of national company law. This is also proved by the fact that the discussions of Working Group I frequently refer to topics such as legal entities owning UNLLOs, interconnection of business registers, boards of directors, scaling up and cross-border transactions: all these matters are hardly of any interest for one person or family micro-businesses in developing countries, and they reveal what could be the potential implications of the UNCITRAL initiative on MSMEs for company law in general.<sup>26</sup>

#### *V. Conclusion*

This paper examined UNCITRAL's recent initiative addressed to MSMEs. After having provided a short outline of the evolution of the initiative elaborated by Working Group I, I have analysed previous attempts at harmonizing company law at the regional level. I have examined in particular the experiences of the European Union, OHADA, the Caribbean countries and OAS, also evaluating how these experiences may contribute to the debate currently taking place within UNCITRAL. Finally, I have investigated the broader implications of the UNCITRAL project, and recommended that careful consideration be paid to the regional harmonization experiences that have successfully created a meaningful harmonized company law.

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<sup>26</sup> On the possible future directions of the UNCITRAL initiative on MSMEs, see Callison — Fenwick — McCahery — Vermeulen, *Corporate Disruption: The Law and Design of Organizations in the 21st Century*, available at <http://ssrn.com/abstract=2818383>, last visited on December 20, 2016.

## Problems on harmonization and unification of international commercial law

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### 1. Introduction

Considering the large amount of instruments created artificially or spontaneously aiming to harmonize and unify international commercial law, it is important to analyse which are the main problems arising from the present reality in order to deal with such issues and try to surpass their difficulties.

This paper highlights the main problems applicators in general (judges, arbitrators, etc), States, and International Organizations, including UNCITRAL, face when dealing with harmonization and unification of international commercial law. Consequently, the intention is that such problems are taken into account in order to improve the effectiveness of harmonizing/unifying instruments and mechanisms.<sup>2</sup>

Therefore, the subject issue of this paper concerns which problems emerge when harmonization and unification of international commercial law are sought; *i.e.* which difficulties should be considered when looking for efficient results on granting better-shaped-to-reality international commercial instruments,<sup>3</sup> since their creation until their application.

In this sense, problems can be divided into two categories: (i) one including problems accruing from the relationship between instruments and States; and (ii) other including problems accruing from the relation among instruments themselves. In the first category are included problems related to the drafting (and creation) of harmonizing/unifying instruments; their use (choice); their application by different applicators (judges, arbitrators); and situations that jeopardize their complete application, such as public policy issues and mandatory rules. In the second category are placed problems related to creation and drafting of instruments and their application.

However, before entering the subject itself, it is important to clarify some aspects concerning the terminology used, especially the terms *unification* and *harmonization*.<sup>4</sup> Unification takes place when (i) there is only one instrument to be applied; and (ii) the result of such application worldwide is similar enough that it leads to the avoidance of practical differences that may result in a specific choice of the applicator.<sup>5-6</sup>

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<sup>1</sup> This paper consists in a short version of our Master thesis. Issues were identified and more deeply analysed in our text presented and defended in Portuguese at the University of São Paulo Faculty of Law in May 2016 under the title: *Desafios da Harmonização do Direito do Comércio Internacional*. Available at: <http://www.teses.usp.br/teses/disponiveis/2/2135/tde-25102016-162941/pt-br.php> accessed on 08 January 2017.

<sup>2</sup> The word *Mechanism* is used for the purpose of this paper as the way all available instruments can be used in order to harmonize or unify international commercial law.

<sup>3</sup> The word *Instrument* is used for the purpose of this paper as rules containing any kind of command or guideline that can be used in order to harmonize or unify international commercial law. It means that the instrument may be used for a purpose different to the one it was created for.

<sup>4</sup> It is possible to notice some terminological differences concerning texts written in different languages. Especially in French and in Portuguese three words are used: *harmonização/harmonization*, *unificação/unification* and *uniformização/uniformization*. In English, the large majority of authors, including International Organizations, use two words: *harmonization* and *unification*. In this sense, *unificação/unification* and *uniformização/uniformization* are treated as unification in this paper, as criteria used to treat them separately do not prevent their union. Also, such choice avoids misunderstandings regarding texts written in English.

<sup>5</sup> Such definition was based on the following texts: ANDERSEN, 2007; BOELE-WOELKI, 2010; KAMDEM, 2009; DOLINGER, 2008; OLIVEIRA, 2008; UNCITRAL, 1970, p. 13; MATTEUCCI, 1957; DAVID, 1968; BONELL, 1990; BOGGIANO, 2000; FARIA, 2009; DE LY, 1997; ANDERSEN, 2007, UNCITRAL Website <[http://www.uncitral.org/uncitral/en/about/origin\\_faq.html#harmonization](http://www.uncitral.org/uncitral/en/about/origin_faq.html#harmonization)> (accessed on 08 January 2017); Unidroit Institute Website <<http://www.unidroit.org/about-unidroit/overview>> (accessed on 08 January 2017). Hague Conference Website <[http://www.hcch.net/index\\_en.php?act=text.display&tid=26](http://www.hcch.net/index_en.php?act=text.display&tid=26)> (accessed on 08 January 2017).

<sup>6</sup> Although some authors use the expression *forum shopping*, it is not used here because, considering such concept and some divergences on its definition, some situations in which harmonizing/unifying instruments could be

Harmonization, in turn, has two meanings. The first one is used when an instrument works as model or source of inspiration to the creation or the application of another instrument in order to bring them closer and facilitate commercial relations. The second concerns harmonization seen as the harmonic coexistence of instruments.<sup>7</sup>

Therefore, any instrument can be used as a means of harmonization or unification, regardless the aim it was created for. Generally speaking, any source of international commercial law can be seen as a kind of harmonizing/unifying instrument.<sup>8</sup>

Considering the definition brought above, problems on harmonization/unification of international commercial law are any factors jeopardizing the fulfilment of at least one of the requirements of harmonization/unification as defined above.

Once unification requires (i) the existence of only one instrument (ii) applied similarly enough that the result of such application avoids practical differences, one may conclude that unification is not achieved if, regarding requirement (i), there is no harmonizing/unifying instrument to be applied or available instruments are not applied, or, regarding requirement (ii), the same instrument is applied differently, being this a reason for choosing one applicator or another.

Further, once harmonization requires the use of an instrument as model or source of inspiration in order to get them closer and facilitate commercial relations, problems arise when no instrument is used as model or source of inspiration or if such use does not result in the facilitation of commercial relations. The same is true when instruments do not coexist harmonically.

In the following topics, every problem mentioned above will be dealt with individually.<sup>9</sup> However, before moving on to such analysis, it is important to highlight that the existence of harmonizing/unifying instruments does not mean diversity itself is a problem. The existence of multiple instruments available means applicators can choose the one that best fits their relation. In addition, propagation of such multiplicity of instruments will, at last instance, show which are better suited for each relation and which should not be kept. In other words, practice will show which critics to which instruments are correct and which are not. The most important is that the content of one instrument does not harm the existence of a multiplicity of possibilities and their application. The application of each instrument must be made consistently worldwide no matter the applicator chosen.<sup>10</sup> Further, it is important to bear in mind that harmonization and unification should be sought as a means for a further objective.<sup>11</sup>

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used would be left out.

<sup>7</sup> Such definition was based on the following texts: KAMDEM, 2009; BOELE-WOELKI, 2010; OLIVEIRA, 2008; LEBOULANGER, 2009; DAVID, 1968; UNCITRAL Website <[http://www.uncitral.org/uncitral/en/about/origin\\_faq.html#harmonization](http://www.uncitral.org/uncitral/en/about/origin_faq.html#harmonization)> (accessed on 08 January 2017); Unidroit Institute Website <<http://www.unidroit.org/about-unidroit/overview>> (accessed on 08 January 2017); Hague Conference Website <[http://www.hcch.net/index\\_en.php?act=text.display&tid=26](http://www.hcch.net/index_en.php?act=text.display&tid=26)> (accessed on 08 January 2017).

<sup>8</sup> Based on: BASSO, 2011, p. 24-114; GALGANO & MARRELLA, 2011, p. 193-304; and BORTOLLOTTI, 2009, pp. 9-122.

<sup>9</sup> Critics to the creation and to the application of harmonizing/unifying instruments may also be considered a challenge as they could result in the non-application of instruments. Most common critics can be found on STEPHAN, 1999; GOPALAN, 2003; GOODE, 2003, item I; GOODE, 2005, p. 556; ROSETT, 1992, p. 688; DE LY, 1997, p. 529; SACCO, 2001, pp. 174-175. If on the one hand the above mentioned authors present critics, on the other, they also present suggestions to reduce them.

<sup>10</sup> SACCO, 1990, p. 2 e 15; SACCO, 2001, p. 175-180; LOSANO, 2007, p. 18; MISTELIS, 2000, p. 1068; ANDERSEN, 2007, p. 48-49; KRONKE, 2009, p. 708; BOISSÉSON, 1999, p. 598.

<sup>11</sup> BOELE-WOELKI, 2010, pp. 336-337.



## 2. *Problems accruing from the relation between instruments and States*

### i. *Drafting, creation (regarding only the relation with States) and incorporation of instruments*

The first problem has its origins in the existence of different juridical systems.<sup>12</sup> Such differences usually lead to long discussions during the drafting of harmonizing/unifying instruments. Therefore, the careful choice of their characteristics can help facilitating their drafting process and the fulfilment of goals.<sup>13</sup> During such process, every state-representative tend to defend their States' own interests, which may result in incompatibilities. When it comes to the drafting of soft law instruments, conversely, text incompatibilities are not that relevant because their binding force is given by the parties or States that can adapt the content if they want. Another difference regards drafters, who usually are not state representatives, but experts on the subject matter.<sup>14</sup>

The second problem relates to the decision of a state to become bound by an instrument or not. When it comes to bringing international and transnational instruments to state legal order, it is the state itself the one to take decisions, such as: to become part to treaties, to use model law texts when drafting domestic legislation, to allow arbitration procedures, etc.<sup>15</sup> Such decisions take into account multiple aspects that may impair the effectiveness of harmonizing/unifying instruments.

Some of them are: the existence of other priorities;<sup>16</sup> the reduced number of State-parties;<sup>17</sup> the reduced personnel available to represent the country in conferences or meetings where the drafting is made<sup>18</sup>; apprehension on the results of the application of instruments;<sup>19</sup> avoidance of costs (which arise from the training to apply a new instrument);<sup>20</sup> lack of foreseeability regarding results of application;<sup>21</sup> preference for domestic law;<sup>22</sup> and incompatibilities with domestic law (mandatory rules and public policy issues).<sup>23</sup>

Reservations<sup>24</sup> and differences resulting from some states being bound to a treaty and others not also lead to discrepancies in their application as the content made bound on each state changes.<sup>25</sup> However, if reservations were not allowed, it is likely treaty acceptance would be reduced.

Also, the way each State faces international and transnational instruments can be considered a problem, especially regarding the hierarchical level international law instruments are placed in each legal order.<sup>26</sup> When domestic law prevails over international instruments, international commercial relations may be given a legal treatment that is not consistent with best practices.

<sup>12</sup> MATTEUCCI, 1957, p. 415.

<sup>13</sup> MATTEUCCI, 1957, p. 420

<sup>14</sup> *Soft Law* is understood here as any kind of instrument that were not given binding force by the state. They depend on party autonomy to become binding. ABBUD, 2014, p. 13-14; For further issues on the subject: BONELL, 2005, p. 229; KAUFMANN-KOHLER, 2010, p. 2; DI ROBILANT, 2006, p. 500; ANDERSEN, 2007, p. 16; GABRIEL, 2009, p. 655; BOYLE, 1999, p. 901-902; GERSEN & POSNER, 2008, p. 6; KAUFMANN-KOHLER, 2010, p. 2; FLÜCKIGER, Alexandre. Why Do We Obey Soft Law?. in NAHRATH, Stéphane; VARONE, Frédéric (eds), *Rediscovering Public Law and Public Administration in Comparative Policy Analysis: A Tribute to Peter Knoepfel*, Lausanne: Presses polytechniques et universitaires romandes, 2009, p. 45-62 *apud* KAUFMANN-KOHLER, 2010, p. 2- 3; BASSO, 2011, p. 94-96; ABI-SAAB, 1993, p. 59-60.

<sup>15</sup> BOELE-WOELKI, 2010, p. 364.

<sup>16</sup> SONO, 2007, p. 2.

<sup>17</sup> SONO, 2007, p. 2; FARIA, 2009, p. 26.

<sup>18</sup> BASSO, 2011, p. 49.

<sup>19</sup> SONO, 2007, p. 2.

<sup>20</sup> SONO, 2007, p. 2; FARIA, 2005, pp. 9-10.

<sup>21</sup> SONO, 2007, p. 2.

<sup>22</sup> FARIA, 2005, p. 9

<sup>23</sup> KLEINHEISTERKAMP in VOGERNAUER & KLEINHEISTERKAMP, 2009, p. 129-130; JAYME, 1995, p. 228; BODEN, 2002, p. 88; BASSO, 2011, p. 297-298; MCCLEAN, 2000; PIERRE MAYER, 1998; BENNETT, 2002.

<sup>24</sup> BONELL, 1990, p. 866-867.

<sup>25</sup> FERRARI, 2002, pp. 703 e 704.

<sup>26</sup> BASSO, 2011, p. 50, footnote 77; CASSESE, 2013, p. 299-306.

In order to encourage states to become bound to a certain instrument, a provision containing an authorization to opt-out the entire text or to modulate its content may be considered a good idea. An example of such kind of provision is article 6 CISG.<sup>27</sup> The counterpart of such flexibility however is the existence of multiple possibilities of variation, harming the achievement of wider unification.<sup>28</sup>

Applicators may also avail themselves of provisions such as article 6 CISG when taking into account the limited scope of application of harmonizing/unifying instruments. In order to avoid *dépeçage*, national law may be preferred for it reaching a wider scope of application, so the same legal order is applied to all subjects dealt within the contract, which reduces the use of harmonizing/unifying instruments.<sup>29</sup>

It leads to the conclusion that harmonizing/unifying instruments, although having a limited scope of application, should be harmonized with the content of other harmonizing/unifying instruments, in order to encourage their choice. In this sense, the wider the scope of application of harmonizing/unifying instruments, the more parties feel encouraged to allow their application to their commercial relations. Further, when bringing harmonizing/unifying instruments to the domestic legal order, their translation is an issue to care. The use of different translation methods may lead to text distortions and, consequently, to misunderstandings on their application.<sup>30</sup> Even if drafting techniques are different, efforts should be applied by domestic law drafters so harmonization is kept.<sup>31</sup>

Another delicate issue regards changes made to the original text due to update reasons.<sup>32</sup> The consent of all States may be required once more and, usually, enormous difficulty is faced to reach consensus again. Therefore, problems arising from outdated provisions should be resolved through interpretation techniques, either considering the current practice of international commercial law, or making use of most recent instruments containing provisions on the specific subject. Provisions on filling gaps may be used for this purpose too.<sup>33</sup> In this sense, the more harmonizing/unifying instruments are known around the world, the easier it will be to find a solution to update their text without having to change the original text. Formulating agencies play a very important role in disseminating such knowledge.<sup>34</sup>

In addition, undue influence of domestic law on the application of international instruments must be avoided because such influence may harm the attainment of the aim pursued.<sup>35</sup>

## *ii. Application of harmonizing/unifying instruments*

The application of harmonizing/unifying instruments is a fundamental step to reach harmonization and unification. Therefore, every aspect in their reaching will be analysed separately.

As it was explained before, unification is reached when there is one instrument being applied and its application is similar enough that it avoids practical differences harming such application. Reaching harmonization, instead, means one instrument is used as a model or source of inspiration to others either through interpretation or drafting in order to facilitate commercial relations, or their harmonic coexistence.

Bearing these definitions in mind, one concludes it is the way the instrument is applied that determines whether it was used to harmonize or unify international commercial law.

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<sup>27</sup> FERRARI, 2002, p. 700

<sup>28</sup> CISG-AC Opinion No. 16.

<sup>29</sup> KOEHLER & GUO, 2008, pp. 55-56.

<sup>30</sup> BONELL, 1990, p. 867.

<sup>31</sup> FARIA, 2005, p. 30-31.

<sup>32</sup> FARIA, 2005, p. 13.

<sup>33</sup> SCHWENZER & HACHEM In SCHLECHTRIEM & SCHWENZER, 2010, p. 134; FARIA, 2005, p. 13; BEAUMONT, 2010, p. 32.

<sup>34</sup> FARIA, 2009, p. 27; Reaching the same conclusion: DAWWAS & SHANDI, 2011, p. 841; BOSCOLO, 2016, *passim*; SCHLECHTRIEM, 2005, p. 29.; SONO, 2007, p. 6.

<sup>35</sup> MATTEUCCI, 1957, p. 423.

Therefore, when analysing the application of harmonizing/unifying instruments, the following aspects will be taken into consideration: (1) who is applying the instrument; (2) which instruments the parties are allowed to choose and which instruments the applicator is allowed to apply; (3) the relation of such instruments with others (especially the ones of domestic legal order, mandatory rules and public policy issues); (4) *stricto sensu* application of instruments.

As aspect (1) influences aspects (2), (3) and (4), our analysis will focus on aspects (2), (3) and (4), considering the applicator being a judge or an arbitrator when necessary.

(a) *Which instruments the parties are allowed to choose and which instruments the applicator is allowed to apply*

Generally speaking, conflict of laws rules are strictly related to which instruments the parties are allowed to choose and to which instruments the applicator is allowed to apply.

In this sense, harmonizing/unifying instruments may be related to conflict of laws rules in three different forms: being the subject matter of such instruments, being the rule determining the application of harmonizing/unifying instruments on material rules, and filling gaps left by harmonizing/unifying instruments.<sup>36</sup>

As said above, some harmonizing/unifying instruments have as subject matter conflict of law rules. However, when it comes to international commercial law, material rules instruments are usually given preference, but it does not mean conflict of law instruments are not welcome.<sup>37</sup> In fact, the purpose conflict of law rules are built for has changed a little.<sup>38</sup>

Further, conflict of laws rules can be used to regulate the application of harmonizing/unifying instruments. Such rules can be seen from two different perspectives: (1) rules contained in the instrument that deals with its own application and (2) national conflict of law rules allowing or not the application of harmonizing/unifying instruments.

From the first perspective, conflict of law rules could fit for self-applicable instruments when states are bound to them,<sup>39</sup> but should not be used as the first option rule determining their own application because it could lead to distortions on the application of the instrument. Anyway, such instruments are ready to be applied and will be applied if application criteria are met.<sup>40</sup>

Instruments that are not self-applicable or although self-applicable are not being used as such (in case the state is not bound to them) depend on party autonomy to become applicable. Non-binding instruments, in turn, usually contain parameters that indicate situations to which they could apply, but still depend on party autonomy to be applied.

When it comes to the application of non-binding instruments, also said non-self-applicable, conflict of law rules play an important role<sup>41</sup> and dispute settlement provisions too. The large majority of states allow only the application of laws (and not *rules of law*) through conflict of law rules.<sup>42</sup> Therefore, the main problem impairing unification/harmonization concerns the recognition of legislative competence of other authorities by states.<sup>43</sup>

<sup>36</sup> JAYME, 1995, p. 57.

<sup>37</sup> JAYME, 1995, p. 252.

<sup>38</sup> DE LY, 1997, p. 534-535; BADÁN, 2012, p. 80 For example, recently the Hague Principles on Choice of Law in International Commercial Contracts were created.

<sup>39</sup> BADÁN, 2012, 43-44.

<sup>40</sup> BOELE-WOELKI, 2010, P. 396.

<sup>41</sup> BOELE-WOELKI, 2010, p. 396.

<sup>42</sup> On the definition of law, see: MICHAELS, 2009, pp. 14-16; GRIGERA-NAÓN, 2001, p. 25-26.

<sup>43</sup> JAYME, 1995, p. 262-263; BERGER, 1999, p. 30-31. See also the official commentary to article 3 of the Principles on Choice of Law in Commercial Contracts (HPCL). Such instrument allows the parties to choose

The dispute settlement method chosen plays also an important role. When parties choose arbitration, their scope of choice regarding the applicable *law* is wider. The application of soft law instruments can be authorized as it depends on party autonomy and, therefore, parties' choices.<sup>44</sup> If the controversy is submitted to domestic courts instead, state rules will set forth what is allowed or not.<sup>45-46</sup> In sum, the main concerns are (i) whether parties should be authorized to widely and freely choose (regardless the dispute settlement method chosen) and (ii) whether domestic judges should be authorized to widely and freely apply harmonizing/unifying instruments which the state is not bound to.

When it comes to filling gaps resulting from the incompleteness of harmonizing/unifying instruments, three perspectives are considered. One is wider and the other two are stricter. The wider regards the subject-matter of instruments. Differently from domestic law, harmonizing/unifying instruments concern a specific subject matter.<sup>47</sup> Therefore, commercial relations involving various subjects must be given coherent treatment considering every aspect concerned. Harmonizing/unifying instruments individually may not be considered sufficient. In this case, a possible solution is using multiple harmonizing/unifying instruments (when possible) or conflict of laws instruments.<sup>48</sup>

The two stricter perspectives are: (1) issues explicitly left out of the scope of the instrument and (2) issues in the scope of the instrument but not explicitly dealt within its text. Therefore, if some subjects cannot be dealt with within a unifying/harmonizing instrument, although related to it, they may be subject to rules that present at least some coherence to it. A text containing conflict of law rules that indicate the best solution is an option. Issues contained in the subject matter of the instrument, but not receiving specific treatment, should be subject to a provision on filling gaps regarding this kind of situation.

Therefore, the main problem concerning the filling of gaps is granting coherence to the treatment of all issues concerned. Harmonic solutions are the aim to be sought and can be reached if harmonizing/unifying instruments present coherent contents and their use is allowed by the state.

*(b) The relation of harmonizing/unifying instruments with mandatory rules and public policy issues*

The relation between harmonizing/unifying instruments and mandatory rules and public policy issues is considered a problem because the last two limit party autonomy and act preventing the complete application of instruments in order to grant protection to national legal orders.<sup>49</sup>

Theoretically, when it comes to self-applicable instruments given binding force by the state, mandatory rules and public policy issues do not show if the instrument is applied for such a reason. This is so, because such issues should have been raised when the instrument was incorporated to the domestic legal order. Further, party autonomy is not used but to exclude their application. Therefore, conflicts with mandatory rules and public policy issues arise when a non-self-applicable instrument is applied.<sup>50</sup>

Thus, excluding cases related to the paragraph above, four issues concerning the conflict between mandatory rules and/or public policy issues and harmonizing/unifying instruments are the most relevant ones and will be considered here: (1) harmonizing/unifying instruments (soft law) applied as applicable law; (2) foreign law applied in a state whose national law is based on the same instrument as the foreign

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rules of law as long as they are "generally accepted" and are considered a "neutral and balanced set of the rules". This is so to try to keep parties' power balanced, otherwise one party could use its bargain power and impose its set of rules to the other. Available at <<https://www.hcch.net/en/instruments/conventions/fulltext/?cid=135#text>> accessed on 08 January 2017

<sup>44</sup> DE LY, 1997, pp. 538-539; BLACKABY, 2009, p. 226; BORN, 2009, p. 2154; BOELE-WOELKI, 2010, p. 396-430.

<sup>45</sup> BOELE-WOELKI, 2010, p. 400.

<sup>46</sup> Brazilian law is a very clear example of such difference.

<sup>47</sup> FERRARI, 2002, p. 698-699.

<sup>48</sup> MATTEUCCI, 1957, pp. 403-405; DE LY, 1997, p. 534.

<sup>49</sup> BERAUDO, 2005, p. 104-105; BOGGIANO, 2000, p. XI.

<sup>50</sup> Issues arise regarding the underlying subject matter to which the instrument is applied, not the instrument itself. The compatibility of the instrument with the domestic legal order was analysed when the state became bound to it.

law; (3) provisions on mandatory rules and public policy issues contained in harmonizing/unifying instruments; and (4) public policy issues faced during proceedings for recognition and enforcement of sentences and awards.

- (1) In case of conflict between soft law instruments and national mandatory rules or public policy issues, the latter ones prevail.<sup>51</sup> If the dispute settlement mechanism is arbitration, as arbitrators should deliver an enforceable award, mandatory rules and public policy issues are to be taken into account on a case by case basis in order to avoid problems of enforcement.<sup>52</sup>
- (2) In case of application of foreign law, conflicts with mandatory rules and public policy issues may occur.<sup>53</sup> Therefore, the more the domestic law and the foreign law are harmonized, the less mandatory rules and public policy issues will show up.
- (3) Provisions regarding mandatory rules and public policy issues and their conflict with applicable instruments are usually drafted to restrict the most the application of exceptions. As restrictive as their application may be, such kind of provision is always present, so exceptions are allowed and states feel encouraged to accept the application of harmonizing/unifying instruments.<sup>54</sup> In sum, states can avail themselves of an escape valve in order to protect their fundamental values and rules; but such protection should only be used in extreme cases.
- (4) Countries with different levels of development may have different levels of protection and, consequently, more or less tight enforcement standards.<sup>55</sup> Treaties on recognition and enforcement of judicial sentences are rare.<sup>56</sup> Conversely, when it comes to arbitration, the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards plays a very important role, facilitating the global circulation of awards. Although its success, public policy issues are still responsible for discrepancies on its application.<sup>57</sup> Further, the rising idea of transnational public policy is also relevant.<sup>58</sup> On the one hand, difficulties arise regarding the definition of its content and the possibility of its application before state courts (as the concept was created in relation to arbitration). On the other, transnational public policy allows applicants to take into consideration largely protected interests, fostering harmonization.<sup>59</sup> Regional public policy is also an issue to care, as organizations might prefer considering regional standards instead of national ones.<sup>60</sup>

<sup>51</sup> DE LY, 1997, p. 537.

<sup>52</sup> PIERRE MAYER, 1998, p. 6. Some authors consider arbitrators must always take into account mandatory rules existing in every state where the parties might seek recognition and enforcement of the award because arbitrators have a duty to deliver enforceable awards. On the one hand: KLEINHEISTERKAMP in VOGERNAUER & KLEINHEISTERKAMP, 2009, pp. 133-134; BONELL, 2005, p. 248-249. On the other: MAYER, Pierre, *La règle morale dans l'arbitrage international*, in *Études offertes à Pierre Bellet* 379, ¶¶ 26-27 (1991), *apud* FOUCHARD & GAILLARD & GOLDMAN, 1999, pp. 881-882.

<sup>53</sup> MATTEUCCI, 1957, p. 420.

<sup>54</sup> Comments to HPCL (Art.11) <https://www.hcch.net/en/instruments/conventions/fulltext/?cid=135#text> accessed on 08 January 2017; PERMANENT BUREAU HCCH, 2009, p. 6-8. MAX PLANCK INSTITUTE, 2003, p. 82. It is important to keep in mind the exceptional character of such provisions, otherwise applicators may look for alternative ways to overcome them, leading to forum shopping and avoiding a proper solution to the core of the problem. See MUIR WATT & RADICATI DI BROZOLO, 2004.

<sup>55</sup> BASSO, 2011, p. 292. In the same sense: KLEINHEISTERKAMP in VOGERNAUER & KLEINHEISTERKAMP, 2009, pp. 133-134.

<sup>56</sup> BASSO, 2011, pp. 303-304.

<sup>57</sup> MAYER & SHEPPARD, 2003, Recommendations 1.b and 1.c; MUIR WATT & RADICATI DI BROZOLO, 2004, p. 92; BOISSÉSON, 1999, pp. 597-598.

<sup>58</sup> GALGANO & MARRELLA, 2011, p. 914-934.

<sup>59</sup> PIERRE MAYER, 1998, p. 5; For example: UN Global Compact. Disponível em <<https://www.unglobalcompact.org/what-isgc/mission/principles>> accessed on 08 January 2017.

<sup>60</sup> MAYER & SHEPPARD, 2003, Recommendation 1.c.

(c) *Stricto sensu application of instruments*

In this topic remaining issues on the application of harmonizing/unifying instruments will be considered, once all other impediments have already been dealt with on previous topics.

First, the focus is on unification, precisely on its requirement of application being done similarly enough by applicators so the choice of the applicator is not relevant to the result obtained.<sup>61</sup>

The main problems in this section are related to diverging interpretation of instruments due to language discrepancies<sup>62</sup> and the influence of domestic legal orders to the application of harmonizing/unifying instruments.<sup>63</sup>

Regarding language discrepancies, applying interpretation rules is the best approach. Such rules are usually found in the instrument text or in the 1969 Vienna Convention on the Law of Treaties. In relation to the influence domestic legal orders play, interpretation rules are also relevant, mostly the ones determining harmonizing/unifying instruments must be interpreted autonomously and considering their international character.<sup>64</sup> Further, the more information on such instruments is spread on the domestic level, the more correct their application will be. It is especially true when information is available on the judge's mother-tongue.<sup>65</sup>

Initiatives on spreading knowledge on unifying/harmonizing instruments are very welcome and considered the best way to increase their adequate application. Databases containing doctrine, case law, and information on harmonizing/unifying instruments are very important too.<sup>66</sup> Courses are a great kind of initiative too and should be directed not only to university students, but to graduated applicators that are unfamiliar to the field and anyone else interested in the subject.<sup>67</sup> However, efforts should be applied to increase the number of arbitral awards made available to applicators.<sup>68</sup> Considering the more specialized character of arbitration decisions, the publication of arbitral awards content could help spreading the most adequate fashion of applying harmonizing/unifying instruments.<sup>69</sup> Obviously, the confidentiality must be preserved.

Further, the creation of an international court to improve harmonization/unification of international commercial law is not recommended. This is so for two main reasons: there is no guarantee the existence of such a court leads to an adequate application of harmonizing/unifying instruments (as it is possible to verify from domestic courts);<sup>70</sup> and arbitration is a very used dispute settlement mechanism that would have to be banned if such court were to be effective; *i.e.* the creation of an international court would only fulfil its aims if arbitration was no longer used, what is not possible nor recommended.

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<sup>61</sup> Parallel proceedings (including arbitration) are included in the applicator's selection issues.

<sup>62</sup> BONELL, 1990, p. 867; ULRICH MAYER, 1998, pp. 588-589.

<sup>63</sup> MATTEUCCI, 1957, p. 423-424.

<sup>64</sup> ULRICH MAYER, 1998, p. 599; BONELL, 1990, p. 867

<sup>65</sup> BOSCOLO, 2016, section 2.B.iv.

<sup>66</sup> Some of them are available at: <http://www.unilex.info/>; <https://www.uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf>; <<http://www.cisg.law.pace.edu/>>; <http://www.cisgac.com/>; <<http://www.cisg-brasil.net/>> all of them accessed on 08 January 2017; BERGER, 1999, p. 233. (CENTRAL [http://www.central-koeln.de/en\\_ID122](http://www.central-koeln.de/en_ID122) accessed on 08 January 2017) Regarding the CISG Advisory Council, see also: KARTON & DE GERMANY 2009.

<sup>67</sup> FARIA, 2009, pp. 33-34.

<sup>68</sup> DE LY, 1997, p. 545.

<sup>69</sup> DE LY, 1997, p. 545.

<sup>70</sup> ANDERSEN, 2007, p. 6-7; JAYME, 1995, p. 259.

Some initiatives on regional level were taken, such as in the European Union<sup>71</sup> and in the OHADA.<sup>72</sup> However, obstacles are faced when trying to grant cohesion and efficiency to the system, what shows a global initiative would be subject to difficulties too.<sup>73</sup>

Second, there is the possibility some instruments are used to aid the interpretation of others. We could call it “harmonizing interpretation”. Any instrument may be used for this purpose.<sup>74-75</sup> The aim is bringing the content of such instruments into domestic law in order to encourage their use in the national level and bring new ideas to national law, fostering harmonization too.<sup>76</sup> In this sense, knowledge sharing is mandatory, so applicators can identify cases to which these *new* instruments may be used and, therefore, use harmonizing interpretation more frequently.

### 3. *Problems accruing from the relation among Harmonization and Unification instruments themselves*

The relation among harmonizing/unifying instruments takes place in mainly two ways: during their creation and during their application/interpretation. Every instrument may work as source of inspiration or model for others. In this sense, it is very important to bear in mind pre-existent instruments and their content in order to avoid collisions and contradictions and, consequently, grant cohesion to the system. Generally, during application, the level of compatibility of instruments varies according to their binding force and scope of application.

Considering the large quantity of instruments already created and, therefore, made available to applicators, new instruments should be based on deficiencies of the existing system.<sup>77</sup> Besides, the feasibility of the proposed solution should be analysed.<sup>78</sup> Balance between diversity and harmonization/unification is important, as well as between rigidity and flexibility of rules.<sup>79</sup>

In this sense, formulating agencies should work together to optimize their activities and avoid the drafting of conflicting or overlapping instruments. They should take into account both formal and material characteristics of the instruments.<sup>80</sup>

Regarding global and regional instruments, it is important to define their scope of application very well, so initiatives created by one formulating agency are not lost due to others created in the opposite sense by another one.<sup>81</sup>

The “dialog of sources”<sup>82</sup> is the best approach to grant harmonic solutions when it comes to the application of more than one harmonizing/unifying instrument simultaneously. Hard law and soft law instruments should be used together in order to improve harmonic coexistence of instruments and the achievement of better practical results. The same is true considering the relation between harmonizing/unifying instruments and domestic law.<sup>83</sup>

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<sup>71</sup> BIAVATI, 2009, p. 411-426; RIECHENBERG, 2004, p. 321.

<sup>72</sup> LEBOULANGER, 2009, pp. 548-549.

<sup>73</sup> ANDERSEN, 2007, p. 6-7; JAYME, 1995, p. 259.

<sup>74</sup> As seen on KULESZA, 2015, pp. 319-321.

<sup>75</sup> BIN, 1993, p. 475.

<sup>76</sup> BIN, 1993, p. 475-479.

<sup>77</sup> BOELE-WOELKI, 2010, pp. 336-337.

<sup>78</sup> GOODE, 2003, item I.

<sup>79</sup> BERGER, 1999, p. 206-212; DE LY, 1997, pp. 523-536.

<sup>80</sup> FARIA, 2009, p. 22; BONELL, 1996, p. 245; DE LY, 1997, p. 536.

<sup>81</sup> KRONKE, 2004, p. 476-477; FARIA, 2009, p. 25; GARRO, 2015, pp. 2-5; MAYER, 2008, p. 400-401; BONELL, 1996, p. 233.

<sup>82</sup> JAYME, 1995, p. 259.

<sup>83</sup> BOELE-WOELKI, 2010, p. 344; BASSO, 2011, p. 98; KRONKE, 2004, p. 475; BOSCOLO, 2015.; VISCASILLAS, 1998, item VI.B. In the same sense KRÖLL & MISTELIS & VISCASILLAS 2011, p. 289-290; CISG-AC Opinion n.13, p. 21-22; AGRO, 2011, p. 733; BONELL, 2002, p. 348-349; ULRICH MAYER, 1998, p. 599; BADÁN, 2012, p. 50; KRONKE, 2014, p. 38.

#### 4. Conclusion

Highlighting problems on harmonization and unification of international commercial law is the first step in order to optimize efforts to facilitate international commercial relations. Next step is taking such issues strongly into account when drafting, interpreting and applying harmonizing/unifying instruments. Formulating agencies play a very important role in this mission, such as States, all other applicators, and academics. Of course this is not an easy task as there are many interests and difficulties involved.

In this sense, the word that should guide works in this field for the next years is balance: balance between divergence and equality; balance between existing instruments and societies' new needs; balance between rigidity and flexibility; and last but not least, balance between party autonomy and State power. Bearing this in mind, activities should be focused on initiatives aiming at solving deficiencies of the existing system.

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## *Session 4 — Integrated systems to support cross-border trade*

### *Towards a ‘digital fitness check’ for existing legal instruments*

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UNCITRAL has been a leading force in assisting legislatures worldwide with the challenges posed by the transformation of commerce from the analogous to the digital world. The legal notions of non-discrimination, technological neutrality and functional equivalence formulated by UNCITRAL have remained, until the present day, the cornerstones of effective and sustainable legislation in the field. And yet, the question arises whether UNCITRAL texts can remain as they are or whether they, too, are in need of a ‘digital fitness check’.

#### *1. UNCITRAL work in the digital field*

UNCITRAL has produced a range of very influential work in the digital field itself. The 1996 UNCITRAL Model Law on Electronic Commerce (MLEC) purports to enable and facilitate commerce conducted using electronic means. In particular, it is intended to overcome obstacles arising from mandatory statutory provisions by providing equal treatment to paper-based and electronic information. Similarly, the 2005 UN Electronic Communications Convention aims at facilitating the use of electronic communications in international trade by assuring that contracts concluded and other communications exchanged electronically are as valid and enforceable as their traditional paper-based equivalents. The 2001 UNCITRAL Model Law on Electronic Signatures (MLES) aims to enable and facilitate the use of electronic signatures by establishing criteria of technical reliability for the equivalence between electronic and hand-written signatures. And only very recently, the Model Law on Electronic Transferable Records (MLETR) has been adopted, which legally enables the use of electronic transferable records that are functionally equivalent to transferable documents and instruments including bills of lading, bills of exchange, promissory notes and warehouse receipts.

#### *2. A new stage in digitalisation*

However the world has changed and digitalisation has recently entered a new stage that does not find itself reflected in the existing UNCITRAL texts so far, in particular not in those that have not originally been drafted with digitalisation in mind.

##### *(a) Sale of ‘smart’ goods under the CISG*

One example is the impact which the Internet of Things has on contract law. Sales law used to be about the relationship between a seller and a buyer, which is reflected in the United Nations Convention on Contracts for the International Sale of Goods (CISG). In the digital age, however, goods are not just tangible movable items. Rather, they are embedded with electronics, software, sensors, and network connectivity that enable them to collect and exchange data and to be sensed and controlled remotely across existing network infrastructure. This is a reality with the majority of new-bought cars, TV sets and ICT equipment, but the phenomenon is spreading to almost any kind of movable item or its packaging, including textiles and food. The emergence of connected goods (‘smart goods’) and connected packaging (‘smart packaging’) means a revolutionary change for sales law because the buyer, and even more so the buyer who is an end user, will enter into direct contractual or quasi-contractual relationships with the manufacturer or other third parties, such as licensors of embedded software or the providers of digital services. When smart goods or smart packaging connect to the Internet, buyers are often forced to conclude a series of post-sale agreements by clicking a button or performing a similar act. This means that the sales contract is just one of various transactions which the buyer has to make in order to be able to transport, resell, or use the goods in accordance with the sales contract, and that the seller is just one of several parties with whom the buyer and end user has a direct relationship with regard to the goods.

Even though CISG is, generally speaking, probably better in a position to deal with smart goods than many national legal systems it fails to capture the essence of the sale of smart goods and to address a number of salient issues, such as (i) that the goods need not only be free from claims of third parties (Article 41 CISG) but that they must come with claims against third parties, e.g. for online services and updates, and that the seller's position in that regard needs to be defined; (ii) that the goods need not be free from IP rights (Article 42 CISG), but that they must come with appropriate licenses for embedded and ancillary software; and (iii) that the scope of rights the buyer will have vis-à-vis third parties (e.g. rental allowed? number of users?) needs to be as carefully defined as the quality.

*(b) Data as collateral under the MLST*

Another example is the use of data as collateral for a security interest. With the rising significance of data as an asset and tradeable item it is hardly satisfactory to see that it cannot serve as collateral in order to improve the availability of credit in the industry 4.0. The UNCITRAL Model Law on Secured Transactions (MLST), however, remains entirely silent in this regard. As there would need to be asset-specific rules for security interests in data if data were admissible as collateral silence arguably amounts to a negative answer, i.e. it is arguably not well possible under the MLST to grant a security interest in data.

In practice, parties can achieve satisfactory results by storing the data exclusively on the secured party's servers, but the debtor may need to store the data on its own servers for technical and operational reasons. As far as the secured party still has a copy of the data it can nevertheless sell the data on the market where the debtor is in default and where this is provided by the security agreement or applicable law, but the secured party will then compete on the data market with the trustee in bankruptcy, which will normally mean that proceeds of any sale will be lower. Also, a crucial point may be the relationship between a 'security interest' in the data and ownership or any security interest in the servers on which data are stored (or in the right against a storage provider, e.g. a cloud provider). The perfection of a security interest would prevent third parties from disposing of the data in their own right, either exclusively or as competing suppliers on the data market.

There should be a debate whether perfection can occur by putting the secured party in 'possession' of the data, i.e. the secured party must have exclusive control of the data and the debtor must be able to access and process the data only through the secured party. This can be achieved, e.g., by creating a protected space on the debtor's servers that can be accessed only with the help of a digital key controlled by the secured party. Where the data are stored in Cloud space provided by a third party, the same effect could be achieved by way of a control agreement or of the secured party becoming the holder of the Cloud space. Alternatively, the applicable law may allow for perfection by filing in a registry.

*(c) The MLST and self-executing 'smart contracts'*

A third example would be the relationship between the MLST and self-executing contracts. When speaking of 'self-execution', at least three different levels can be identified. The lowest level would be simple electronic seizure or repossession, e.g. the creditor switches off essential components of a device, of a production line etc. in order to put the debtor and any other person who intends to use the device under pressure. The next level would be advanced electronic seizure or repossession, e.g. assets are redirected by way of remote control, such as a self-driving car to the creditor's premises or goods to his warehouse. Such advanced electronic seizure may involve the use of blockchain technology but may equally be triggered by other means. Both levels of electronic seizure or repossession pose a challenge for the MLST insofar as it may mean 'factual perfection' without the creditor being in possession of the encumbered asset and without filing in a registry. The highest level is fully automated self-execution, i.e. in a situation of default value that is represented by a virtual currency or similar digital assets is automatically transferred from the debtor's to the creditor's account. For the time being, such fully automated self-execution normally involves blockchain technology.

As yet, the MLST fails to reflect the expectation that secured transactions will, in the future, normally involve electronic enforcement, e.g. that (i) technical solutions may be as important as written security



agreements, that (ii) what is coded in the blockchain may be as important as what is recorded in the registry, and that (iii) rules on restitution for unjustified enforcement may be as important as rules on how to achieve enforcement. Admittedly, some types of electronic enforcement may simply be held to be incompatible with the MLST, i.e. the law of a jurisdiction that has adopted the MLST may consider electronic enforcement as plainly unlawful because it serves to circumvent the traditional law of secured transactions and gives the creditor an unfair advantage over the other creditors. On the other hand, declaring self-execution to be plainly unlawful would mean a quite far-reaching restriction of freedom of contract, as self-execution is achieved by a combination of contractual agreement and technical solution and not by way of property law.

### *3. Conclusions*

The three examples serve to illustrate that we might be well advised to reconsider existing legal instruments — in particular UNCITRAL model laws or conventions — in the light of new stages in digitalisation and make them undergo a ‘digital fitness check’. In addition to revising existing legal instruments, it could make sense to take a broader perspective and to develop a set of principles that would guide legislators worldwide in the difficult task of updating their existent legislation in a variety of fields. In order to provide for flexibility, the work should initially be conducted by an expert group. This expert group could develop results that might then be submitted to one or several UNCITRAL Working Group(s) for further consideration.

## *Ownership of data and the numerus clausus of legal objects*

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### *1. Introduction*

In 1974 Grant Gilmore wrote that contract was dead.<sup>1</sup> We now know that it was not. Recently, authors have written about the end of ownership and the beginning of the end of classical contract law.<sup>2</sup> Again it is argued that traditional private law concepts, such as ownership and contract, are in crisis. Gilmore argued that contract was drowning in a sea of tort and pleaded for a new law school course on contorts.<sup>3</sup> Law curricula did not change. Perzanowski and Schultz argue that due to the rise of the Internet of things, the sharing economy with its on-line platforms and digital rights management, we can see a paradigm shift from ownership to access: assets are no longer controlled (“owned”) by one particular subject, but accessed whenever needed.<sup>4</sup> Savelyev confronts the traditional role of the state in the development and enforcement of private law with the rapidly evolving block chain technology and, closely connected with this, smart (i.e. algorithm governed) contracts. Will the state lose control and will algorithms govern us? In other words: algorithms as law instead of the rule of law over algorithms?<sup>5</sup> Before we embark on another theory of “crisis”, let us first see if there really is a crisis or that we are, as we always have been, in a process of ongoing development of the law, only different from the past because of the speed of change and the growing complexity of legal sources given globalisation with its de-nationalisation, now, so it seems, more and more counter-balanced by growing re-nationalisation and localisation, which latter development makes the picture even more complex than it already was.

In the following paragraphs I will first make some introductory remarks on what is meant when reference is made to the “classical” model of private law. I will then discuss “data” as a new object of property law, whether these data can be included in, what I have called, the “numerus clausus of legal objects”, what the consequences are of accepting data as a new legal object for our understanding of ownership (more particularly ownership as the foundation of trade in a market economy).<sup>6</sup> Finally, I will draw some tentative conclusions.

### *2. “Classical” private law*

It is interesting to note that Savelyev refers to “classic” contract law. What is meant? Generally speaking, authors who refer to classical contract law mean contract law (or more generally: private law) as it was developed during the 19<sup>th</sup> century.<sup>7</sup> When analysing this classical model of private law two layers

<sup>1</sup> G. Gilmore, *The Death of Contract* (2<sup>nd</sup>. ed.; Columbus: Ohio State University Press, 1995).

<sup>2</sup> A. Perzanowski and J. Schultz, *The End of Ownership. Personal property in the digital economy* (Cambridge, Mass./London: MIT Press, 2016), with accompanying website: [www.theendofownership.com](http://www.theendofownership.com); A. Savelyev, *Contract law 2.0: “Smart” contracts as the beginning of the end of classic contract law*, Basic research program working papers, series: law, WP BRP 71/Law/2016 (National Research University Higher School of Economics, Moscow), available at the Social Science Research Network (SSRN): <https://ssrn.com/abstract=2885241>.

<sup>3</sup> Gilmore, *The Death of Contract*, p. 98.

<sup>4</sup> Perzanowski and Schultz, *The End of Ownership*, p. 1 ff.

<sup>5</sup> See L. Lessig, *Law regulating code regulating law*, *Loyola University Chicago Law Journal* 2003, p. 1 ff.

<sup>6</sup> Cf. for a more traditional analysis of objects of property law (such as the human body, pecuniary claims, social security benefits, public law licenses), not discussing the question of new objects resulting from the impact of digitalisation on property law, A. Praduroux, *Objects of property rights: old and new*, in: M. Graziadei and L. Smith, *Comparative property law. Global perspectives* (Cheltenham/Northampton, MA: Edward Elgar, 2017), p. 51 ff.

<sup>7</sup> As I already discussed the classical model of private law in earlier writings, for further references I would like to refer to J.H.M. van Erp, *Contract als Rechtsbetrekking. Een rechtsvergelijkende studie* (“Contract as a form of Legal Relationship. A comparative study”) (Zwolle: W.E.J. Tjeenk Willink, 1990), p. 1 ff., S. van Erp, *Teaching law in Europe: From an intra-systemic, via a trans-systemic to a supra-systemic approach*, in: A.W. Heringa and B. Akkermans (eds.), *Educating European lawyers* (Cambridge/Antwerp/Portland: intersentia, 2011), p. 79 ff., p. 81 ff. and S. van Erp, *Lex rei sitae: The territorial side of classical property law*, in: Chr. Godt (ed.), *Regulatory property rights. The Transforming notion of property in transnational business regulation* (Leiden/Boston: Brill Nijhoff, 2016), p. 61 ff.

can be distinguished. A first (formal) layer, consisting of values, policies, leading principles, ground rules and technical rules: the “type” of law that applies. A second (substantive) layer, focussing on subjects, objects and relations: the “living” law. I will refer to these layers when discussing the model. “Classical” private law was developed in 19th century Europe after the French Revolution, but before the rise of Marxism and before the Industrial Revolution. Consequently, it focussed on land as the most important source of wealth and the “*citoyen*”, the well-to-do citizen. The ideological framework underlying the model was based on the ideals of the French Revolution, particularly “*égalité*” (equality, no differences should be made based upon status such as being of nobility) and “*liberté*” (freedom, stressing the autonomy of the individual and a person’s free will), resulting in a liberal (and thus market based) approach to economic relations. The third ideal of the French Revolution “*fraternité*” was, so it seems, more of a moral than a legal nature. The model was also based on a clear division of power between the legislature and the judiciary. The primary law maker was the legislator, the judge was to follow and apply the law with only limited power to create (secondary) case law. Although in England the judge still was the person seen as the ultimate arbiter regarding what the law was, parliament was sovereign and consequently had the power to change the law, so also in England the legislator was stronger than the judge. During the period in which the classical model of private law was developed also the rise of the nation-state can be seen, a nation-state which not only had a territory in Europe, but also outside Europe. The nation-states were colonial powers. Law on the continent of Europe became based on national codes and thus petrified; in England the doctrine of “*stare decisis*” essentially had the same effect. It is remarkable to note that the inward looking approach never resulted in a complete closing of the mind towards “foreign” influence. Countries which took over the Napoleonic Civil Code, to give but one example, kept looking at the development of private law in France. While colonising other countries, the European nation-states tried to influence the law in the colonies by introducing (and imposing) their own law. This can be seen as a form of globalisation of the law in a period during which, remarkably enough, in Europe the law became more and more national. Today we see a resurgence of this inward looking trend when it is argued that a country (nation) should first look after its own interests and that international economic and legal cooperation is only a second best alternative. Lessons learnt in the 19<sup>th</sup> and 20<sup>th</sup> centuries — and organizations such as UNIDROIT and UNCITRAL are the direct outcome of that experience — show that a tendency to (re)nationalise the law will always encounter barriers of economic interdependence and international trade.

Based upon this ideological framework the classical model of private law took as its starting point that we should, first of all, separate liability questions (rights “*in personam*”) from questions of wealth (rights “*in rem*”). Liability (the law of obligations) was inter-personal; wealth (the law of property) was about a person and his assets or, to formulate it more precisely, legal relations between a subject vis-à-vis a substantial number of other subjects regarding an object. The law of property functioned against the background of contract law. Because property law gave citizens strong rights against “the world”, these rights were seen as in need of strict mandatory regulation and also in need of strict justification, given that everyone was bound by these rights without personal agreement. In other words: contract law was the default regime, resulting in personal liability, property law was the regime of exception, resulting in creating rights about wealth “*erga omnes*”. When it was attempted to create a property right and this attempt failed, the law of contract, being the default system, might still impose, albeit personal, liability. If parties wanted to create a servitude, but for some reason were unsuccessful, they still were bound among themselves by their agreement. Also personal liability was strictly separated into two categories, depending upon whether it resulted from a person’s free will to enter into a legal relationship with another person of free will (“meeting of the minds”, contract) or whether the liability was imposed by the law (especially tort and unjustified payment). Liability imposed by the law could only happen under very strict conditions. Broken down contract negotiations could, therefore, not result in liability: No contract had been concluded yet, good faith only had a limited impact and also tort law did not intervene with duties governing behaviour during negotiations. Of course, liability could have an impact on a person’s wealth (positively, as creditor, or negatively, as debtor), but questions of wealth were still seen as separate from liability, given the *in rem* character of rights regarding wealth. Questions of wealth were governed by property law, which dealt with a person’s shadow in the material world: the “*patrimoine*” or “*Vermögen*”. A patrimony consisted of all of a person’s assets: physical things (particularly land), but also immaterial assets such as monetary claims arising from inter-personal liability. Whereas these claims were qualified negatively from the perspective of liability law (in other words: they were qualified from the debtor’s side) as “obligation”, they were

qualified positively (in other words: from the creditor's side) in the world of wealth. In some legal systems the separation was complete, as can be seen in German law with the two leading dogmas: "*Trennungsprinzip*" (principle of separation of the law of obligations and the law of property) and "*Abstraktionsprinzip*" (principle under which legal acts affecting property relations are independent from the impact of the law of obligations). In French law, however, this separation has never been this strict, given the rule that a contract of sale transfers ownership, at least between the parties and against third parties in good faith.

With regard to contract law this "classical model" can be found back in the theory that contracts come into existence after a "meeting of the minds", based on the ground rule that a contract results from the mechanism of offer and acceptance. Given the autonomy of the individual ("freedom of contract" becoming the leading principle in this area of the law), a policy choice had been made to only introduce a few filters to check whether the will had been really free. A contract could be avoided if, e.g., the will had been influenced by fraud. Justified by the autonomy of the parties the content of their agreement was in their hands, again with only a limited filter to check this: contracts violating public policy or good morals were invalid. However, the number of mandatory laws was limited, and so was the possible impact of public policy. Good faith was a concept that continental legal systems did accept, but only with regard to performance and enforcement of contracts. A contract, once concluded without any defect regarding the parties' free will and without violating the limited reasons for invoking public policy or good morals, was binding, irrespective of changing circumstances afterwards.

It will be obvious that, although this classical approach still can be traced in today's contract law, many of the assumptions underlying the model are no longer accepted. Individual autonomy is frequently absent when looking at a party's free will not from a formal, but from a substantive viewpoint. This explains the rise of heteronomous rules to protect those renting a dwelling house, employees and consumers. Individual autonomy is almost completely absent when accepting general terms and conditions: these are "take it, or leave it" contracts, often regarding goods or services one cannot really do without. Good faith is more and more seen as an overall norm of behaviour, which may also govern contract negotiations. This, however, does not mean that contract law is "dead". It still does make a difference whether liability is contract based or tort based, because it does matter if the parties involved, albeit perhaps to a very limited degree, accepted liability or not. What about property law?

The "classical" model of private law also deeply affected property law. The main object of wealth in the 19<sup>th</sup> century was land. Before the French Revolution land was still governed by a legal structure which emanated from the feudal system with its "*duplex dominium*" (dual ownership) of "*dominium directum*" (ownership in the hands of those who were nominal owners) and "*dominium utile*" (ownership of those who actually lived on and benefitted from the land). Part of the feudal system were positive feudal duties, such as the duty resting on the holder of the *dominium utile* to pay part of the harvest to the holder of the *dominium directum*. No developed system of land registration existed and secret — even general — mortgages could be established.<sup>8</sup> As a consequence of the French Revolution on the Continent of Europe this feudal system of land holding was abolished and dual ownership was replaced by a unitary concept of ownership, albeit in France less strict than in Germany.<sup>9</sup> Ownership was seen as the ultimate expression of freedom, which had both a positive and negative effect. An owner was entitled to the use and benefits of assets, could do which the asset as he pleased and was free to transfer it. He could also stop anyone from interfering with his asset. English property law did not know this abolition of the feudal system and remained, at least in theory, based upon feudal notions. It also preserved its own approach to fragmentation of ownership as a result of the interplay between Common Law and Equity culminating in the concept of the trust with its "legal" and "equitable" entitlement. With the abolition of the feudal system, the acceptance of positive burdens, which could bind a successive owner by force of law, disappeared. Classical property

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<sup>8</sup> Cf. V.J.M. van Hoof, *Generale zekerheidsrechten in rechtshistorisch perspectief* (Deventer: Wolters Kluwer, 2015).

<sup>9</sup> See W. Swadling and B. Akkermans, *Types of property rights: Immovables and movables in: S. van Erp and B. Akkermans (eds.), Ius Commune casebooks for the common law of Europe, Cases, materials and text on national, supranational and international property law* (Oxford/Portland, Or.: Hart Publishing, 2012), p. 211 ff.

law distinguished different degrees of property rights: primary rights (ownership in the Civil Law, freehold and title in the Common Law) and secondary rights (property rights of a lesser nature). To a rather limited extent, as this violated separating liability from wealth questions, tertiary rights were recognized: rights which are in between contract law and property law. Tertiary rights have effect against third parties, but not against everyone, such as the lessee who is protected against the consequences of sale of the leased premises by the owner/lessor.

In the development of “classical” property law France — understandably, in light of its revolutionary history — made the choice to first of all protect ownership. This explains the choice for a causal system of transfer, returning ownership to the seller in case of, e.g., avoidance of the sales agreement. Almost a century later, in the heyday of the Industrial Revolution (so under different economic circumstances than the drafting of the French Civil Code), the German legislator made a choice for protecting commerce by strictly maintaining the difference between the law of obligations and the law of property. It is interesting to note that English law seems to have made another policy choice, by not abolishing the feudal system and maintaining its duplex ordo of Common Law and Equity. By means of equitable doctrines English property law is able to give legal protection to economic interests. The beneficiary under a trust is, although not entitled to the trust property under Common Law, still “owner” under the law of Equity, because of his apparent need to see his economic interest protected by the law.

To buttress post-revolutionary property law and prevent any reintroduction of the feudal system, classical property law introduced three leading principles. First of all, the principle of “*numerus clausus*” of property rights, to protect the newly introduced concept of unitary ownership against a return of quasi-ownership rights under the cloak of creating new secondary property rights. This *numerus clausus* of property rights has both a substantive and a procedural side, because this principle not only limits the number and content of such rights, but also how these rights are created, transferred and extinguished. Following the *numerus clausus* principle, next to full ownership only property rights less than ownership (secondary or so-called “limited” property rights) could be created. These limited property rights are of three types: use rights (such as servitude), security rights (e.g. mortgage) and management rights (trust and trust-like devices). The *numerus clausus* of property rights was accompanied by the principle that property rights follow a hierarchy (to be found in such ground rules as that older rights have priority over younger rights) and the principle that property rights must be transparent (e.g. by registration in case of immovable property). It could be said that the feudal period under which secret mortgages were allowed, which from a present day perspective could be seen as the ultimate protection of a mortgagor’s privacy, was replaced by a period more focussed on providing information to third parties, under which full disclosure was demanded.<sup>10</sup>

It is against this background that for a considerable period of time property law became a rather static area of the law, relatively unaffected by the tumultuous developments of contract and tort law. Of course, under the influence of modern financing German law accepted the transfer of ownership for security purposes, but changes like this remained within the outer limits of the existing classical system. This can be seen when looking at what I called the second layer of that system. Earlier I defined property law as the law which governs legal relations between a subject and a considerable group of other subjects regarding an object. Who, generally speaking, can be a subject of property law did not change fundamentally: natural and legal persons (under both private and public law). The objects which property law recognizes (“legal objects”) generally are physical (tangible) assets, such as land and movables and, although in some legal systems more explicit than in other legal systems, intangibles, such as monetary claims, to which can be added intellectual property. Classical property law does not recognize new legal objects quickly. This can be seen with regard to the acceptance of public licenses as tradable objects and concerning the acceptance of different types of market quota, such as emission rights and milk quota. In my view this approach can be

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<sup>10</sup> Regarding access to land registration data, as we see it today, a clear conflict of interest exists between those who are registered as being entitled to a property right and who claim privacy protection, third parties who have the right to be informed about the existence of rights which can be invoked against them and the general interest, which may demand as much public access as possible to prevent falsification and corruption regarding entries in the land registry.

qualified as a different type of *numerus clausus* doctrine, as the number and nature of legal objects is limited. This *numerus clausus* of legal objects buttresses the *numerus clausus* of property rights, as it limits the objects as to which a property right can be claimed. The definition of a property right might even contain the object as to which such a property rights is possible. Although the two types of *numerus clausus* are, therefore, linked to one another, each type fulfils a different function. The *numerus clausus* of property rights limits the number and content of these rights, without limiting the objects which can be protected by rights *erga omnes*. The *numerus clausus* of legal objects provides the limitation concerning the objects and by doing so separates the more restricted category of what can be an object of property law from a broader category of what can be an object of contract law.

From the perspective of traditional — or should I, from today’s perspective, say: “analog”? — property law, as briefly sketched above, the prime questions with regard to the proprietary nature of data are whether (1) they can be accepted as legal objects of property law, (2) whether this has an impact on the nature and content of any property rights regarding such content and (3) if we are really talking about the “end” of ownership, or perhaps even classical property law. These questions will be discussed in the following paragraphs.

### 3. *Data as a new legal object*

The term “data” covers an incredibly vast area of information. All information needs a carrier. This can be the human mind (a person’s memory), the human body (think of genetic information), but also a non-human physical carrier, such as a hard disk, usb stick or chip, either connected to your local computer or a (cloud) server.<sup>11</sup> It seems that courts are in agreement that if data cannot somehow be specified, data are seen as pure information which as such cannot be, at least without any further justification, an object of property law. Examples are the English Court of Appeal in *Your Response Ltd. v. Datateam Business Media Ltd* and the New Zealand Supreme Court in *Jonathan Dixon v. The Queen*.<sup>12</sup> Another question is whether information can be seen as an object separate from the carrier, in other words whether information is of a tangible or an intangible nature and can be the object of ownership independently from (ownership of) the carrier. The Louisiana Supreme Court ruled in *South Central Bell Telephone Co. v Barthelemy*, a tax case, that software was tangible personal property.<sup>13</sup> The New Zealand Supreme Court took a different, less principled and more pragmatic, approach in *Jonathan Dixon v. The Queen*. The court ruled (Arnold, J.):

<sup>11</sup> Cf. on genetic information already L.B. Andrews, Legal aspects of genetic information, The Yale Journal of Biology and Medicine, 1991, p. 29 ff.

<sup>12</sup> Cf. *Your Response Ltd. v. Datateam Business Media Ltd.*, Court of Appeal of England and Wales [2014] EWCA Civ 281; *Jonathan Dixon v. The Queen* [2014] NZCA 329 (CA516/2013) and [2015] NZSC 147 (SC 82/2014). See the opinion by Floyd, L.J., in *Your Response v. Datateam*: “42. I would add only one observation in connection with the wider implications of Mr. Cogley’s (the lawyer arguing for Your Response, JvE) submission that the electronic database was a type of intangible property which, unlike choses in action, was capable of possession and thus of being subject to a lien. An electronic database consists of structured information. Although information may give rise to intellectual property rights, such as database right and copyright, the law has been reluctant to treat information itself as property. When information is created and recorded there are sharp distinctions between the information itself, the physical medium on which the information is recorded and the rights to which the information gives rise. Whilst the physical medium and the rights are treated as property, the information itself has never been. As to this, see most recently per Lord Walker in *OBG Ltd v Allan* [2007] UKHL 21, [2008] 1 A.C. 1 at [275], where he is dealing with the appeal in *Douglas v Hello*, and the discussion of this topic in Green & Randall, The Tort of Conversion at pages 141-144. If Mr. Cogley were right that the database could be possessed and could be the subject of a lien and that its possession could be withheld until payment and released or transferred upon payment, one would be coming close to treating information as property. That observation further underlines the significance of the step we were invited to take.”

<sup>13</sup> *South Central Bell Telephone Co. v Barthelemy*, 643 S2d 1240 (La 1994). The court ruled (Hall, J.), 643 S2d p. 1250: “In sum, once the “information” or “knowledge” is transformed into physical existence and recorded in physical form, it is corporeal property. The physical recodation of this software is not an incorporeal right to be comprehended.” See S. Bagert, *South Central Bell v Barthelemy*: The Louisiana Supreme Court determines that computer software is tangible personal property, Tulane Law Review 1995, p. 1367 ff. and R. Dankner Goldman, From Gaius to Gates: Can civilian concepts survive the age of technology?, Loyola Law Review 1996, p. 149 ff. Cf. for a more general comparison K. Moon, The nature of computer programs: tangible? goods? personal property? intellectual property?, European Intellectual Property Review 2009, p. 396 ff.

“[49] (...) In *Your Response Ltd v Datateam Business Media Ltd* the Court of Appeal held that it was not possible to exercise a common law possessory lien over an electronic database. While the Court did not rule out the possibility that such a database might be property, it said that it was at best intangible property and so, on the authorities (*OBG Ltd v Allan* in particular), did not represent “tangible property of a kind that is capable of forming the subject matter of the torts that are concerned with an interference with possession”.

[50] The key question for us is whether the digital files are “property” for the purposes of s 249(1)(a) (Crimes Act 1961, SvE) rather than whether they are tangible or intangible property, given that the definition of “property” in s 2 includes both tangible and intangible property. What emerges from our brief discussion of the United States authorities is that although they differ as to whether software is tangible or intangible, they are in general agreement that software is “property”. There seems no reason to treat data files differently from software in this respect. Even though the English Court of Appeal considered that an electronic database was not tangible property capable of being converted, it acknowledged that it might be property.

[51] (...) We consider that interpreting the word “property” as we have is not only required by the statutory purpose and context but is also consistent with the common conception of “property”.

What does become clear is that, if information is not somehow specified, it cannot be an object of property law. This is in conformity with one of the leading principles of property law: transparency. The principle of transparency in a classical sense only had two aspects: the object as to which a property right was claimed had to be clearly described and delineated (requirement of specificity) and it had to be made public (possession could imply information, but also registration). This transparency principle, given the pre-Internet age in which it was developed, assumed (physical) barriers, for example that a person asking for information on immovable property had to present himself in person at a land registration office or that only those who had a legitimate interest would ask and be given the requested information. These barriers protected the holder of a property right against information requests from third parties with no legal interest and in fact gave the right holder a privacy-like protection. However, as a consequence of present day information technology developments, traditional barriers to acquiring information are disappearing and the risk increases that information is becoming too easily accessible to persons who cannot show any legal interest whatsoever. The two requirements which constitute the transparency principle (specificity and publicity) are, therefore, now more and more seen as requirements which have to be balanced against the requirement of privacy. The person holding a property right is seen as entitled to be shielded from publicity in situations where third persons do not have a legitimate interest in the information.<sup>14</sup>

Particularly the specificity requirement could guide us towards criteria to establish which (types of) information can be recognized as legal objects (i.e. objects of property law). Once information (data) is specific enough to be considered an object of property law, it can be qualified as a virtual asset and questions regarding the publicity requirement, balanced by the privacy requirement, will have to be answered. In this contribution I will focus on the requirement of specificity, as I consider this to be a preliminary question that has to be asked before the publicity requirement needs to be considered.

When analysing types of information to see if information could be qualified as a legal object, I will focus on information stored on a non-human carrier, although this limitation might be questionable, because a chip might be implanted in a human body.<sup>15</sup> Already chips are implanted in animals, such as pets or cattle.

Ownership of the carrier will be governed by classical property law, particularly because it is a physical, movable thing. This means that the traditional approach to property law can be followed: Property law begins where a subject enters into legal relations with a considerable group of other subjects regarding

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<sup>14</sup> It is interesting to note that even before the Internet Technology Revolution the German land registration system already knew the requirement of legal interest if someone requested information on a registered immovable. See M. Hinteregger and L. van Vliet, *Transfer systems*, in: S. van Erp and B. Akkermans (eds.), *Cases, materials and text on national, supranational and international property law*, p. 844 ff.

<sup>15</sup> Cf. P.M. Schwartz, *Property, privacy, and personal data*, *Harvard Law Review* 2004, p. 2055 ff., p. 2060 ff.

an object, which implies that property law requires the existence of objects outside the human body.<sup>16</sup> In case of an implanted chip (for example as part of a pacemaker) this would mean that the distinction between subject and object is gone, as after implantation the chip has become part of the human body, not unlike an organ transplant. It could then be argued that the data in the chip are to be considered as data comparable to genetic information and should be treated as such, with the consequence that any data in the chip would no longer be governed by (intellectual) property law.

Generally speaking, questions regarding ownership of the physical carrier are seen as different from questions concerning ownership of the data on the carrier, even though data cannot exist without a carrier. With respect to such data we encounter, first of all, the impact of intellectual property law, for example the intellectual property rights regarding software. With software, however, users can create new things: Do these new things fall under the umbrella of the holder of the intellectual property right or did the user of the software create an asset independent from intellectual property law? An example is a car computer, which stores data about the technical functioning of the car (engine, brakes etc.) and might also store data about a driver's behaviour in traffic (your driving style); of course, your navigation system stores your destinations. Who owns the data about your car's engine, your driving style and your destinations? Could you argue that, because you "own" your car according to classical property law, you own the data, as they are information which you created yourself by driving in your own car? Or can your car manufacturer or the manufacturer of your navigation system claim ownership under its intellectual property rights? The answer to these questions is of incredible importance when looking at the marketability of data. From a classical property law viewpoint it is the owner who can transfer. In my view, given the personalised nature of the information, it is the car owner who is entitled to the information, not the holder of the intellectual property right concerning the software in the car. This means that, if the copyright holder of the software wants to have access to the personalised information it will have to be transferred and the car owner will be protected by privacy law.<sup>17</sup>

Looking at the example I gave above, three elements surface to decide if the information is specific enough to qualify as a legal object: (1) nature of the content, (2) the person creating the content and (3) purpose and use of the content.

### *3.1. Nature of the content*

As to content various types can be distinguished: (a) content directly related to the human body, (b) user generated content for personal use, (c) user generated content targeting a specific group or person, (d) mass distributed user generated content (for commercial purposes or non-commercial purposes), (e) open content and (f) agreed upon (commercial) content.

### *3.2. Person creating the content*

Next to this categorisation focussing on the type of content I would like to suggest that we also take into account if data have been created by (a) a specific natural person (private owner of a car or sender of a WhatsApp message), (b) private enterprises (Facebook or Google) or (c) a government body (footage resulting from CCTV surveillance by the police, land registration data administered by a government agency).<sup>18</sup>

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<sup>16</sup> A question which has recently been raised by H. Eidenmüller is whether 'robots' could be given legal personality. That seems, at least for now, unlikely to happen, but the fact that the question has been asked is a sign of how rapidly the technological landscape is changing and how difficult it is for lawyers to evaluate these developments. See H. Eidenmüller, Robot's legal personality, Oxford Business Law Blog 8 March 2017, [www.law.ox.ac.uk/business-law-blog](http://www.law.ox.ac.uk/business-law-blog).

<sup>17</sup> Cf. C. Prins, Property and Privacy: European perspectives and the commodification of our identity, in: L. Guibault and P.B. Hugenholtz (eds.), The future of the public domain. Identifying the commons in information law (Alphen a/d Rijn: Kluwer Law International, 2006), p. 223 ff.

<sup>18</sup> See for a comparable approach, but focussing on consumers' information G. Malgieri, Property and (intellectual) ownership of consumer information: A new taxonomy for personal data, Privacy in Germany — PinG, n. 4, 2016,



### 3.3. Purpose and use of the content

If a person creates data to be used only for personal purposes, this would be an argument in favour of accepting a property entitlement in the hands of that person. However, if the data concerns open content (Wikipedia), the nature of the content is a clear counter-argument. When user generated content targets a specific group or person (WhatsApp), this creates a closer link between the person creating the content and the data than if the user generated data is mass distributed (Facebook). If the content is meant to be exploited for commercial purposes, the person creating the content creates a personal link between him and the content to avoid that others can make use of it freely. This also is an argument in favour of accepting a property entitlement, which will frequently be accepted in any case because of the impact of intellectual property law. However, commercially used digital content in a public private partnership setting might again be differently treated. If a national land registry, government owned and operated, with the assistance of a privately owned Internet technology company is converted from a more traditional (partly paper based, partly digital) registration system to a system completely based on block chain technology and smart contracts, ownership of the data by that company will be of a mixed public/private nature. The result may be that upon termination of its contract with the government this company could be obliged to also hand over its source code, to allow the government access to and control over the stored land data.

These three elements (nature of the content, person creating the content, purpose and use of the content) can be seen as policy weighing factors to decide if the information (the data) is specific enough to be considered an object of property law. Questions regarding publicity and privacy remain. Particularly if the specificity requirement has been fulfilled because of a close nexus between person and content, given the purpose and use of the content, privacy protection will frequently prevail and make the publicity requirement moot.

### 4. Legal objects as qualifier of ownership

The *numerus clausus* of property rights is one of the (not to say: the most important) constituent principle underlying a property law system.<sup>19</sup> What has often not been observed so far on a more general level of abstraction is that property rights are defined from the perspective of the object concerned. Particularly a comparative approach might be revealing. Ownership in the civil law and freehold in the common law are, at least historically, concepts which focus on land. Whether intangible property could be owned was (and still is) a debatable question, the answer to which is based upon age-old discussions about the nature of intangible property. Could it be “owned” as land or was, for example, the contractual source of a monetary claim so directly connected with the *in personam* right between creditor and debtor that the economic value of such a right was fundamentally different from the economic value of physical objects, particularly land?<sup>20</sup> Let me give an example from the Dutch Civil Code, given its relatively recent enactment. The Netherlands Civil Code (article 5:1) defines ownership as follows:<sup>21</sup>

1. Ownership is the most comprehensive property right that a person, the ‘owner’, can have to (in) a thing.

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p. 133 ff., available at SSRN: <https://ssrn.com/abstract=2916058>.

<sup>19</sup> See for an analysis from a comparative and European viewpoint: B. Akkermans, *The principle of numerus clausus in European property law* (Antwerpen: Intersentia, 2008).

<sup>20</sup> Cf. for a comparative study about monetary claims: C. Lebon, *Het goederenrechtelijk statuut van schuldvorderingen* (Antwerpen/Oxford: Intersentia, 2010) and C. Lebon, *Property rights in respect of claims*, in: S. van Erp and B. Akkermans (eds.), *Cases, materials and text on national, supranational and international property law*, p. 365 ff. See also J.L. Bergel, *Les nouveaux biens*, Rapport Général, in: *La Propriété*, Travaux de l’Association Henri Capitant, Tome LIII (Paris: Société de Législation Comparée, 2003), p. 203 ff. ; V. Sagaert, *Nieuwe perspectieven op het eigendomsrecht na tweehonderd jaar Burgerlijk Wetboek*, in: B. Tilleman and P. Lecocq, *Zakenrecht/Droit des biens* (Brugge: Die Keure, 2005), p. 43 ff.; P. Berlioz, *La notion de bien* (Paris: LGDJ, 2007), p. 71 ff. ; Chr. von Bar, *Gemeineuropäisches Sachenrecht*, Band I (München: C.H. Beck, 2015), p. 318 ff. and B. Mallet-Bricout, *Bien et immatériel en France*, in: *L’Immatériel*, Travaux de l’Association Henri Capitant, Tome LXIV (Bruxelles: Bruylant, 2015), p. 149 ff.

<sup>21</sup> Translation to be found on: [www.dutchcivillaw.com/](http://www.dutchcivillaw.com/).

2. The owner is free to use the thing to the exclusion of everyone else, provided that he respects the rights and entitlements of others to the thing and observes the restrictions based on rules of written and unwritten law.
3. The owner of the thing becomes the owner of its separated fruits and benefits, except when another person is entitled to them.

Article 5:2 adds that the “owner of a thing is entitled to (re)claim it from everyone who keeps it without a right or title.” At the heart of this definition is not only the content of the right, but also its qualifier: the object, the “thing”. This is defined in article 3:2: “‘Things’ are tangible objects that can be controlled by humans.” In other words monetary claims and property rights themselves are not “things” and cannot be owned, although the person having the claim or the property right is entitled to it and can, to give but one example, transfer it.<sup>22</sup> What we see is that the definition of the right is directly connected with the object. In Dutch law, following the model of German law, the object must be of a physical, i.e. tangible, nature. Monetary claims cannot be “owned”, one can only be “entitled” to these claims. In other words — taking not so much a dogmatic, but a more functional approach — “ownership” of intangibles is different from “ownership” of tangibles, because the object is different. French law takes a more flexible approach here, but also cannot deny that intangibles are different in nature from tangibles. Mallet-Bricout, therefore, argues that property law concerning physical things is seen as a model for all other types of property entitlements: “Plus généralement, les biens corporels semblent être encore souvent vécus comme des corps étrangers qu’il faut assimiler aux institutions et catégories de notre vieux droit des biens.”<sup>23</sup> Under English law it is even clearer than under Dutch, French and German law, that the object fills the content of the right. The primary right regarding land (“ownership” in the Civil Law) is the “estate in fee simple absolute” or the “freehold”; with regard to receivables and personal property the primary right is “title”. This realisation brings with it that if we are willing to accept new types of legal objects such as data, and then ask the question: “who owns this property?”, we are already in the process of formulating a different type of ownership.<sup>24</sup> This is why, also from a comparative viewpoint, it should be realised that, depending upon the legal object concerned and in light a legal system’s historical development, a more pragmatic approach must be chosen to avoid unnecessary and non-productive academic debate based on sterile dogmatic analysis and preconceived 19<sup>th</sup> century paradigms. We must realise that ownership of physical things is not the same as ownership of a monetary claim or ownership of data. In each case the legal object is different and hence the qualifier of the primary right. Using the same term (“ownership”) is as such of course possible, as long as it is realised that by doing so that particular legal system accepts different types and degrees of ownership. Traditionally, common lawyers, given the *duplex ordo* of common law and equity, are more open to this approach than civil lawyers, who, after the French Revolution, were educated in a legal environment in which *duplex dominium* had been abolished and a unitary concept of ownership — focussing particularly on land — had been introduced. Of course civil lawyers accept that monetary claims can be transferred and pledged, very much like tangible property can be transferred and pledged, but monetary claims cannot be revindicated, neighbour law does not apply, so claims cannot be owned. The protection of monetary claims is a matter for contract and tort law, in other words: the law of obligations, not property law.

The recent changes in the Luxemburg Commercial Code might prove to be a good example of this use of the term “ownership” in a setting where it does not mean ownership in the traditional sense. In 2013 a new version of article 567, paragraph 2, of the Luxemburg Commercial Code was enacted.<sup>25</sup> It now reads:

<sup>22</sup> Cf. W. Loof, *Of Trustees and Beneficial Owners. An inquiry into the proprietary aspects of trusts and trust-like devices from a European Private Law perspective* (Maastricht: Datawyse/Universitaire Pers Maastricht, 2016), p. 8 ff.

<sup>23</sup> Mallet-Bricout, *Bien et immatériel en France*, p. 161.

<sup>24</sup> Cf. J.H.M. van Erp and W. Loof, *Eigendom in het algemeen: eigendom van digitale inhoud (titel 1)*, in: L.C.A. Verstappen (red.), *Boek 5 BW van de toekomst. Over vernieuwingen in het zakenrecht* (Den Haag: SDU, 2016), p. 23 ff.

<sup>25</sup> The parliamentary history can be found on: [www.chd.lu/wps/portal/public/RoleEtendu?action=doDocpaDetails&id=6485](http://www.chd.lu/wps/portal/public/RoleEtendu?action=doDocpaDetails&id=6485).

“Les biens meubles incorporels non fongibles en possession du failli ou détenus par lui peuvent être revendiqués par celui qui les a confiés au failli ou par leur propriétaire, à condition qu’ils soient séparables de tous autres biens meubles incorporels non fongibles au moment de l’ouverture de la procédure, les frais afférents étant à charge du revendiquant.”

The Official Comment explains that this provision was desirable in light of the need to allow reclaiming data from a cloud server in insolvency situations.<sup>26</sup> The aim of the provision is certainly clear, but can the same be said about the property terminology used? Let me start by saying that this attempt by a legislature to offer a practical legal solution in situations which are more and more frequent and where classical property law does not offer workable answers is certainly to be applauded. At the same time it does show how incredibly difficult it is to do this, using the classical framework of property law. The text mentions that the property (defined as: “*les biens meubles incorporels non fongibles*”) must be separable (“*séparable*”), they must either be in the possession of or be held by the bankrupt (“*en possession du failli ou détenus par lui*”) and the property can be revindicated by the person who entrusted it to the bankrupt or who is its owner (“*revendiqués par celui qui les a confiés au failli ou par leur propriétaire*”). This clearly is civil law terminology, more particularly civil law terminology in the French legal tradition. Given that the property may also include specific data (how else to understand movable, non-fungible, incorporeal goods?), the various aspects of specificity discussed above should be taken into account when deciding if data can be qualified as a legal object, an object of property law, which can be revindicated from a cloud server. Taking the approach, advocated above, we should look at the specificity requirement from three angles: nature of the content, person creating the content and purpose and use of the content. I fully agree with the approach taken regarding the requirement that the data must be separable: Only well-defined data can be legal objects. But is it sufficient if the data are stored on a particular drive or in a particular folder, or is it enough to create separate files by using programmes as Word, Excel or Adobe pdf? This is what the specificity requirement is all about. I would argue, following the analysis discussed above, that in the case of e.g. a company’s books, stored on a cloud server, we look at the nature of the content (a company’s books are probably a mixture of user generated content for personal use and user generated content targeting a specific group or person and agreed upon (commercial) content), the person creating the content (probably only a company’s employees or employees of a firm providing the company with bookkeeping services, which also offers cloud storage) and purpose and use of the content (is the purpose only storage or are the cloud services part of an overall book keeping package?). If the specificity requirement has been fulfilled, most likely also the publicity requirement has been put into effect as well, because in the world of intangibles physical signs (for example file names) are necessary to make separated data visible to the outside world. In the case that we are discussing here (a commercial setting and insolvency) the privacy requirement plays a lesser role, as it is the person owning or entrusting the data to the cloud server who revindicates those data. If any privacy protection should be upheld because this person is controlling data about other persons, the already existing privacy provisions will continue to apply. Article 567 Luxembourg Commercial Code also uses the terms “possession” and “hold”. In the French legal tradition possession

<sup>26</sup> The Exposé des Motifs states (No. 6485, Chambre des Députés, Session Ordinaire 2011-2012, Projet de Loi portant modification de l’article 567 du Code de Commerce), p. 2/3: “Le nouvel alinéa 2 de l’article 567 proposé traite du cas des biens meubles incorporels non fongibles. Il a été jugé utile de traiter ce cas à part, dans une nouvelle disposition, étant donné que la revendication en matière incorporelle ne saurait être limitée dans le cas du dépôt et de vente pour compte du propriétaire, comme elle l’est en matière corporelle. Il existe en effet aujourd’hui des hypothèses auxquelles le législateur n’a pas pensé il y a 10 ans et qui sont plus que de simples cas d’école. Ceci est le cas notamment dans le cadre des prestations offertes de façon de plus en plus large, à la fois au public en général et aux professionnels en particulier, en matière d’outsourcing ou d’informatique dématérialisée, appelée communément informatique dans le nuage (*Cloud-computing*). Pour continuer avec l’exemple du Cloud, l’une des applications du *Cloud computing* consiste par exemple pour une entreprise, une association ou une personne privée à ne plus conserver ses données et fichiers voire logiciels sur son propre système informatique, mais de les faire stocker sur des infrastructures informatiques externes accessibles via Internet. Or, il faut faire en sorte que celui qui a recours à de tels services puisse en cas de faillite du prestataire récupérer les données et fichiers afférents, en ce inclus les traitements qui auront été effectués par le failli ainsi que les résultats de ces mêmes traitements. Quant à la recevabilité d’une action en revendication, le texte ouvre le droit à la revendication tant à celui qui a confié les données au failli qu’au propriétaire des données lui-même. Dans certains cas, il s’agira de la même personne; dans d’autres cas il peut s’agir de deux personnes différentes, chacune d’entre-elles disposant dans ce cas d’une action en revendication.”

refers to controlling an object for yourself, holding means controlling an object for someone else (e.g. a lessee holds for a lessor). By using the phrase “*en possession du failli ou détenus par lui*” Luxemburg law in fact introduces a concept of controlling, thus replacing the old traditional distinction between possessing and holding. This does not mean that the German concept of possession has now been introduced, distinguishing two types of possession (“*Eigenbesitz*” and “*Fremdbesitz*”, respectively possessing for yourself or for another person). It means that next to the concepts of possession and holding a new concept is being introduced, taking into account the nature of the legal object: data. With regard to data it is not the traditional concept of possession that is applied, but the concept of control as used in modern Internet technology. Finally, the text introduces “revindication” of data owned or entrusted by the person claiming the data from the cloud server. First of all: the English word “entrusted” is used here purely as a translation of the new term “*confié*”. It is not the word trust as used in English trust law, although it does have a connotation that seems to imply that a person who cannot be seen as owner, but still has a legitimate interest, should also have the right to reclaim the data. I would argue that by introducing a combination of terms, mixing traditional with new terminology (“*revendiqués par celui qui les a confiés au failli ou par leur propriétaire*”) Luxemburg accepts the reality of Internet technology that what would have been revindication in classical property law, now has become what is called “access”. Article 567, par. 2, Luxemburg Commercial Code could therefore be reformulated as follows, and hence also be made applicable in other legal settings:

“Specific data can be accessed and taken under control if the person claiming access and control can show a sufficient link with such data, and if the data can be separated from other data at the moment of opening the insolvency procedure.”

I would submit that discussing property law problems along the lines discussed above might very well offer practical solutions, acceptable also from a trans-systemic and supra-systemic approach. It will, however, require extensive comparative research and rethinking of traditional, classical private law by an interdisciplinary group of experts, consisting of lawyers and Internet technology specialists. UNCITRAL, given its broad experience in the field of international commercial law, would be an excellent platform for such an expert working group.

## 5. Concluding remarks

The classical approach to property law can still be applied to legal objects which have historically been accepted as such: physical things, particularly land and also movable property, monetary claims and intellectual property. Next to the *numerus clausus* of property rights, limiting their number and content, in the civil law strengthened by the unitary concept of ownership, the number and type of legal objects can also be characterised as a *numerus clausus*. The type of object is decisive for the type of applicable property right. I gave the example of Dutch law in which ownership is defined as the most complete right concerning a physical thing. Consequently, if the thing is not physical, that particular object cannot be “owned”. This does not mean that no primary right (in the sense of the maximum of powers, rights, privileges and immunities) exists, but it is not ownership, but entitlement. The legal object is therefore the qualifier for the property right to be applied. In classical property law, if an asset could be qualified as a legal object, still no property right could exist if not a second leading principle had been fulfilled: transparency, demanding a specific description of the object concerned and publicity (balanced by the demands of privacy). When looking at the cases discussed above and particularly analysing the new article 567, par. 2, of the Luxemburg Commercial Code, it seems that — perhaps more implicitly than explicitly and more hesitatingly than boldly — data have been accepted as a new legal object. The difficulties seem more to arise from the requirement of specificity than, among other problems, from the classification of data as tangible or non-tangible.

The approach advocated is of a highly pragmatic nature. Data as falling within the *numerus clausus* of legal objects can only be understood from the perspective of Internet technology. New fitting legal concepts will have to be developed: ownership and revindication must be replaced by control and access; perhaps — so it might be added — the concept of “transfer” should be replaced by “distribution”. Does this mean that classical property law is dead? Or even worse: Is ownership, in the words of the legal realist Felix S. Cohen,

“transcendental nonsense”?<sup>27</sup> Certainly not when we look at the traditionally accepted categories of legal objects. What we see is that classical property law is functioning as a model upon which a new property law can be built. The development of different conceptions of legal objects, with as a result a different approach to property rights and the protection they offer, is nothing new. In the past decades we saw the rise of so-called “constitutional property law”: property law as developed in human rights cases, particularly flowing from the interpretation of provisions in international treaties and constitutions protecting citizens against unacceptable expropriation measures. The nature of the legal field (not private law, but constitutional law) resulted in accepting assets as legal objects, which would not have been qualified immediately as legal objects under classical property law (e.g. rights to payment of a pension by a pension fund).<sup>28</sup> Another new field is European property law, developed by the institutions of the European Union (flowing from the European treaties, legislative measures and case law). Also here new legal objects have been accepted as part of the development towards European-autonomous property rights (e.g. emission rights).<sup>29</sup> The acceptance of data as a new legal object is therefore not revolutionary, but the outcome of the gradual development of property law during the last century in light of changing technological conditions.<sup>30</sup> It can therefore hardly be argued that we see the end of ownership. We only see a changing conception of ownership, which arises from the acceptance of data as a new legal object and results in a new field of property law: digital property rights.

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<sup>27</sup> F.S. Cohen, Transcendental nonsense and the functional approach, *Columbia Law Review*, 1935, p. 809 ff.

<sup>28</sup> For a leading study in the field of constitutional property law see A.J. van der Walt, *Constitutional property law* (3<sup>rd</sup> ed.), (Cape Town: Juta, 2011).

<sup>29</sup> Cf. for an overview of European property law E. Ramaekers, *European Union property. From fragments to a system* (Cambridge/Antwerp/Portland: Intersentia, 2013).

<sup>30</sup> Cf. S. van Erp, Fluidity of ownership and the tragedy of hierarchy. A sign of a revolutionary evolution?, *European Property Law Journal* 2015, p. 56 ff.

## *Implications of the Blockchain Technology for the UNCITRAL Works*

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### *1. Overview*

The blockchain technology is an algorithm which was invented to create the Bitcoin cryptocurrency around 2009. Its significance lies in the fact that it has made it possible for a consensus to be reached (at a practical level) about the evolution of data on an open online network. It thus enables the synchronisation of distributed ledgers without the involvement of a trusted intermediary. For this reason, the blockchain technology is often called “the distributed ledger technology” and helps enhance the security and integrity of data. But the blockchain technology is not just about creating ledgers. It also makes it possible to trade tokens online on a P2P (peer-to-peer) basis and hold them without the involvement of intermediaries. The tokens are either cryptocurrency units of self-anchored value or asset-backed tokens, *i.e.* tokens for which there exists the underlying asset they represent. While the blockchain technology is capable of a myriad of applications, its potential is greatest in the areas where disintermediated P2P transactions can be made possible.

While the Bitcoin’s blockchain is public in the sense that it is a platform open to all who wishes to use it, there have also been many initiatives to create private blockchain platforms: either consortium type or fully private type. In common with public blockchains, they generate append-only distributed ledgers via a chain of blocks. However, unlike public blockchains, they are not open. Thus, consortium blockchains are a member-only platform where there exists an administrator who grants permissions to one group of members to make transactions and another (which may overlap with the former) to do the block validation. In common with public blockchains, however, they dispense with a central registry and operate instead with synchronised distributed ledgers. Accordingly, both public and consortium blockchains fall within the legal analysis of the present article, though which particular legal issues arise will depend on the precise configuration of the particular blockchain such as whether or not it is powered by tokens.<sup>1</sup> Fully private blockchains, on the other hand, merely represent the replacement by the adopting organization of its central database with distributed ledgers. Since it is a purely internal matter of the single organization which adopts it, fully private blockchains do not fall within the present analysis except for the issue to be discussed at Ch. 0 below.

In the first half of this article, we will examine the existing UNCITRAL works to see what legal issues arising from the use of the blockchain technology may be resolved under such works. In the second half, we will turn to examine a practically significant problem raised by the technology which calls for a globally unified solution but is untouched by the existing works of UNCITRAL or any other international organization.

### *2. Under the Model Law on Electronic Commerce (1996) (EC Model Law), the Model Law on Electronic Signatures (2001) (ES Model Law) and the Convention on the Use of Electronic Communications in International Contracts (2005) (EC Convention)*

One of the principles guiding UNCITRAL in its works in electronic commerce is the principle of technology neutrality or technological neutrality, which means that the law should neither require nor assume the use of a particular technology for communicating or storing information electronically.<sup>2</sup> The

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<sup>※</sup> I wish to record my gratitude to the UNCITRAL Secretariat for hosting me as a visiting scholar while I was undertaking research on the present topic. It greatly facilitated my understanding of the working of UNCITRAL.

<sup>1</sup> Depending on the consensus algorithm adopted, a private blockchain does not require tokens of self-anchored value for incentivising the block validation. Even on such a blockchain, it is possible to issue and circulate asset-based tokens, *i.e.* tokens for which there exists the underlying asset they represent.

<sup>2</sup> See the Guide to Enactment of the Electronic Signatures Model Law (2001) para. 5; the preamble of the Electronic Communications Convention. In the context of the EC Model law, the expression “media-neutral” is used to convey the same idea (See the Guide to Enactment of the Electronic Commerce Model Law (1996) para. 24). Only later, has that expression come to be understood as referring more narrowly to non-discrimination

principle helps ensure that the law is able to accommodate future technological developments. Thus, the blockchain technology, though not yet invented when those three instruments were created, is not excluded from their scope of application.

It follows that under the EC Model law, admissibility in evidence or other legal effect may not be denied to information solely on the ground that it is in the form of a data message stored in a blockchain<sup>3</sup> (See Articles 5 and 9). In the context of contracts, an offer and the acceptance of an offer may be expressed by means of data messages stored on a blockchain (See Article 11, as affirmed by Article 8 of the EC Convention). The performance of contractual obligations are also subject to the EC Model Law and the EC Convention.<sup>4</sup> Article 12 of the EC Convention only mentions the formation of contract but States may, where appropriate under their legal systems, extend the principle by providing that the performance of a contract by an automated system may not be denied effect on the sole ground that no natural person intervened in each of the individual actions carried out by the automated system. This would improve clarity with respect to a so-called “smart contract.”<sup>5</sup>

The principle of technological neutrality does not mean that any technology can create a data message which satisfies the paper-based requirements such as those of writing and a signature. Only the technology capable of fulfilling the purposes and functions of the paper-based requirements can create a data message which is deemed to meet those requirements. This is called the principle of functional equivalence, another principle underlying the UNCITRAL works in electronic commerce. Thus, the EC Model law sets out the conditions which a data message must meet to fulfil the purposes and functions of the paper-based requirements of writing and a signature (Articles 6 and 7). The ES Model Law elaborates on the conditions for the signature requirement. A data message stored in a blockchain will be deemed to meet the requirements of writing and a signature if it satisfies the respective conditions. The EC Model law also provides that there must exist a reliable assurance as to the integrity of information contained in a data message before the information is deemed to satisfy the paper-based requirement that it be presented in its original form (Article 8). The blockchain technology is particularly apt to provide a reliable assurance as to the integrity of information since it is tamper resistant.

### 3. *Under the Model Law on Electronic Transferable Records (2017) (ETR Model Law) and the Rotterdam Rules (2008)*

Whereas the three instruments examined above deal with data messages, the ETR Model Law deals with electronic transferable records (Article 1(1)). It sets out the conditions which must be met for an electronic record to be treated as a transferable document (Article 10). The latter is a document that entitles the holder to claim the performance of the obligation indicated in the document and to transfer the right to performance by means of the transfer of that document (Article 2). Bills of lading and warehouse receipts, for example, are covered. Electronic bills of lading are also covered by the Rotterdam Rules (United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea), which calls them “negotiable electronic transport records” (See Article 1(15)).

It should, however, be noted that the ETR Model Law is not applicable to cryptocurrencies such as the Bitcoin because a cryptocurrency holder has no right to claim any performance from anybody. Cryptocurrencies have self-anchored value because the participants in the underlying blockchain system are willing to accept them as a means of payment.

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between paper and electronic media (See the Guide to Enactment of the Electronic Signatures Model Law (2001) para. 5).

<sup>3</sup> It is possible to embed metadata in, for example, the Bitcoin’s blockchain, which allows the extra information to be added to the Bitcoin transactions.

<sup>4</sup> Para. 81 of the Guide to Enactment of the Model Law; Article 1(1) of the Convention.

<sup>5</sup> The expression “smart contract” is a misnomer. It is in fact a computer code stored on a blockchain, triggered by transactions on it and reads and writes data in it: Gideon Greenspan, “Beware the impossible smart contract” (2016) (<http://www.multichain.com/blog/2016/04/beware-impossible-smart-contract/>). The “smart contract” will give rise to a host of new legal issues but its relevance to a contract only lies in the fact that it can automate the online execution of the part of a contract which says “if A happens, then do B.”

It should further be noted that an electronic equivalent of securities (such as shares and bonds) is outside the scope of the ETR Model Law (Article 1(3)). It follows that blockchain-based tokens representing securities (cryptosecurities) cannot be deemed to be securities under the ETR Model Law. A separate legislation would be needed to set out conditions for treating them as legally equivalents. Both the ETR Model Law and the Rotterdam Rules adhere to the principle of technology neutrality. Thus, the draft explanatory notes for the ETR Model Law explain that reference in the Model Law to electronic transferable record management systems does not imply the existence of a system administrator or other form of centralized control.<sup>6</sup>

Both the ETR Model Law and the Rotterdam Rules also adhere to the principle of functional equivalence. They set out the conditions which electronic records must satisfy to fulfil the purposes and functions of the requirements relevant to transferable documents. Among such requirements, most important is the guarantee of singularity. Since a transferable document embodies the right to claim the performance of an obligation from another, it is essential to prevent multiple claims from being made on one and the same obligation. To this end, the law generally requires that there be only one original copy (or one set of original copies)<sup>7</sup> of a transferable document in circulation. In an electronic environment, providing an absolute guarantee of non-replicability may not be technically feasible since systems may retain copies of data. The ETR Model Law seeks to prevent multiple claims by requiring the use of a reliable method to identify an electronic record as the electronic transferable record and establish an exclusive control of it (Articles 10(1)(b)(i)(ii) and 11(1)(a)).<sup>8</sup> The Rotterdam Rules, too, treat the exclusive control of an electronic transport record as functionally equivalent to the possession of a transport document (Article 8(b)). Traditionally, the administrator of an electronic registry has been entrusted to ensure that the relevant electronic records are subject to the exclusive control of their holders. The blockchain technology is now capable of replacing such an administrator with an algorithm which guarantees that there is a single true version of distributed ledgers and ensures that the tokens recorded therein are subject to the exclusive control of their holders, *i.e.* the holders of the private keys.<sup>9</sup> There certainly are possibilities that a private key is disclosed intentionally or accidentally to two or more persons. More than one person would then have control over the cryptocurrency units held in the corresponding address. That would not, however, prevent the control from being characterised as exclusive since those persons have control to the exclusion of all others.<sup>10</sup>

The reliability of the above-mentioned methods will be assessed by adjudicators on an *ex post* (*i.e.* after the occurrence of a dispute) basis. It would, however, be unfortunate if there were no foreseeability as to which methods would pass the reliability test since the use of such methods would then be deterred. A thought should, therefore, be given to the possibility of compiling a list of reliable methods on an *ex ante* basis. Such a list would need to be reviewed from time to time because neither the configuration of a central registry nor the algorithm of a blockchain is permanently fixed.

The ETR Model Law also provides that the requirement of a signature may be met by an electronic transferable record only if a reliable method is used to identify that person (Article 9 on signature). The draft explanatory notes acknowledge that certain electronic transferable records management systems, such as those based on distributed ledgers, may identify a signatory by referring to a pseudonym rather than a real name.<sup>11</sup> The notes suggest that an identification by a pseudonym and the possibility of linking it to a real name, if need be, would satisfy the requirement to identify a signatory.<sup>12</sup> A remaining question is when

<sup>6</sup> Para. 167 of A/CN.9/920 (2017).

<sup>7</sup> It is an age-old practice to issue and circulate multiple copies of an original bill of lading.

<sup>8</sup> Para. 65 of the draft Explanatory Notes (A/CN.9/920 (2017)).

<sup>9</sup> For details, see Koji Takahashi, “Blockchain Technology and Electronic Bills of Lading” (2016) 22 Journal of International Maritime Law 202.

<sup>10</sup> The draft Explanatory Notes, *supra* note 8, also states at para. 95 that the reference to the person in control does not exclude the possibility of having more than one person exercising control.

<sup>11</sup> Para. 60 of A/CN.9/920 (2017). This interpretation is compatible with the understanding expressed in the Guide to Enactment for the Model Law on Electronic Signatures (2001) which states that the concept of identification may rely on other characteristics than a name (para. 117).

<sup>12</sup> Para. 60 of A/CN.9/920 (2017). The same interpretation may be given to the notion of “identification” of the



it is sufficient to rely solely on a pseudonym and when it is necessary to have the possibility of linking a pseudonym to a real name. Signatures have a range of purposes.<sup>13</sup> To take signatures for endorsements as an example, where it is sufficient for signatures to establish that endorsements are back to back as under bills of lading, pseudonyms would be just as good as real names. Where, on the other hand, it is possible to make a recourse against endorsees as under bills of exchange or promissory notes,<sup>14</sup> it will be necessary to have the possibility of linking pseudonyms to real names. The explanatory notes further suggest that linking of a pseudonym to a real name may be based on factual elements to be found outside distributed ledger systems.<sup>15</sup> This stands to reason since sensitive information is not supposed to be stored on open ledgers.

#### 4. *Under the Model Law on Secured Transactions (2016) (ST Model Law)*

Another existing work of the UNCITRAL which has relevance to the blockchain technology is the ST Model Law. Any asset having market value will generate demand for use as a collateral. In the light of the categorization of assets adopted by the ST Model Law, it will be convenient to classify blockchain-related assets into four groups: receivables denominated in a cryptocurrency, the units of cryptocurrencies, blockchain-based tokens representing negotiable documents, and blockchain-based tokens representing securities. After examining the creation and effects of security rights in those assets under the ST Model Law, we will turn our attention to the question whether a blockchain-based distributed-ledger platform may serve as a Registry within the meaning of the ST Model Law. The latter question can arise irrespective of whether the asset itself in which security rights are created is related to the blockchain.

##### *(a) Receivables denominated in a cryptocurrency<sup>16</sup>*

The ST Model Law is applicable to security rights in “movable assets” (Article 1(1)). The words “movable asset” are defined broadly as a tangible or intangible asset, other than immovable property (Article 2(u)). Receivables are thus a “movable asset.” The ST Model Law contains a number of special rules for security rights in receivables (e.g. Article on contractual limitations on the creation of security rights; Articles 61 to 67 on the rights and obligations of third-party obligors). Such rules as well as the general rules contained in the ST Model Law would also be applicable to a receivable denominated in a cryptocurrency.

A right to payment of funds credited to a bank account is a receivable in the ordinary use of the word. But it is excluded from the definition of “receivable” under the ST Model Law (Article 2(dd)) as the latter contains a special set of rules for bank deposits (Article 25 on effectiveness against third parties and Article 47 on priority). If any bank should (by clearing regulatory hurdles) accept deposits in a cryptocurrency, those rules would be applicable to them. Are they also applicable to cryptocurrency units deposited with an online wallet provider? The answer depends on whether the provider falls within the expression “authorized deposit taking institution” within the meaning of Article 2(c) which defines the expression “bank account.” If it is possible to give a broad and non-technical interpretation to those two expressions,<sup>17</sup> an online wallet provider may qualify to be an “authorized deposit taking institution” where it is authorized by law to receive the deposit of cryptocurrencies.

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person in exclusive control of an electronic transferable record, a requirement which must be met to establish functional equivalence to the possession of a transferable document (draft Article 11(1) on control).

<sup>13</sup> See the Guide to Enactment for the Model Law on Electronic Signatures (2001) para. 29.

<sup>14</sup> See Articles 15 and 77 of the Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes (1930).

<sup>15</sup> Para. 60 of A/CN.9/920 (2017).

<sup>16</sup> I wish to record my gratitude to Marek Dubovec for his helpful comments on this and next sections. Any remaining misconceptions are mine.

<sup>17</sup> The enacting State may alternatively wish to consider, as suggested by the draft Guide to Enactment of the Model Law (A/CN.9/WG.VI/WP.73, para. 39) as a possibility, replacing the term “authorized deposit-taking institution” with a generic term broad enough to include any institution authorized to receive deposits.

(b) *Units of cryptocurrencies*

We are here concerned with the creation and effects under the ST Model Law of security rights in cryptocurrency units themselves rather than in a receivable denominated in a cryptocurrency. The practice of granting a consensual lien on cryptocurrency units already exists in financed purchases of them on an exchange.<sup>18</sup>

The ST Model Law provides that any type of movable asset may be encumbered (Article 8(a)) by a security agreement. Cryptocurrency units are a “movable asset,” defined broadly by the ST Model Law as a tangible or intangible asset other than immovable property (Article 2(u)).

In order to create a security right under the ST Model Law, the grantor must have power to do so but does not have to be the owner of the encumbered asset (Article 6 (1)). Indeed, it will not be necessary for the asset to qualify for an object of ownership<sup>19</sup> since security rights need only to capture the value of the asset.

The encumbered asset must be described in the security agreement “in a manner that reasonably allows their identification” (Article 9(1)). This standard is met by a broad description which indicates that the encumbered assets consist of all the grantor’s movable assets within a generic category (Article 9(2)).<sup>20</sup> It follows that a general description “all cryptocurrency” would suffice.

Where a security right is created in cryptocurrency units, the next question which arises is how to make it effective against third parties. One possibility is the registration of a notice with respect to the security right in the Registry (Article 18(1)). Another possibility, the possession of the encumbered asset, is only available to tangible assets under the ST Model Law (Article 18(2)). The ST Model Law being merely a model for legislation, the enacting State may wish to make an exception for cryptocurrency units by equating the possession of a private key for cryptocurrency units to the possession of a tangible asset. The rationale for Article 18(2) is that the transfer of possession of the encumbered tangible asset eliminates the risk that third parties will be misled into thinking that the grantor holds unencumbered title to the asset.<sup>21</sup> The same risk may be avoided where encumbered cryptocurrency units have been transferred to an address for which the secured creditor possesses the private key.<sup>22</sup>

Under the ST Model Law, the word “money” is defined as currency authorized as legal tender by a State (Article 2(t)). A cryptocurrency would be capable of meeting this definition if any State authorized it as its legal tender.<sup>23</sup> However, “money” is supposed to be a tangible asset under the ST Model Law (See Article 2(l)).<sup>24</sup> Consequently, the special rules for preserving negotiability of “money” contained in the ST Model Law (Article 48 on priority) are not applicable to cryptocurrencies. It follows that where cryptocurrency units are subject to a blanket security right covering all of the grantor’s movable assets<sup>25</sup> which has been made effective against third parties by registration,<sup>26</sup> the transferee would acquire them

<sup>18</sup> See e.g. para. 3 of the terms of service of Bitfinex.com (<https://www.bitfinex.com/terms>).

<sup>19</sup> As examined *infra* at ch. 0, whether cryptocurrency units qualify for an object of ownership would currently be an open question under most legal systems.

<sup>20</sup> See also the UNCITRAL Legislative Guide on Secured Transactions (2007) chap. II, para. 58 (p. 79), which notes that many legal systems allow encumbered assets to be described in general terms, acknowledging that specific identification of individual items may not be practical or even possible for certain assets.

<sup>21</sup> See *ibid.*, chap. III, para. 47 (p. 114).

<sup>22</sup> See *ibid.*, chap. I, paras. 80 and 81 (p. 50), where it is observed that in some States, control over intangible assets is treated as a notional possession of them since it achieves the ends comparable to those attained by the possession of tangible assets.

<sup>23</sup> One possibility is to authorise an existing cryptocurrency as a legal tender. There is also the idea of issuing the money of central bank on a blockchain ledger, which has been considered in a number of countries. The latter type of money should, however, be seen as receivables against the central bank denominated in a cryptocurrency and accordingly would fall within the foregoing analysis at Ch. 0.

<sup>24</sup> As seen above, a bank deposit is subject to another set of special rules.

<sup>25</sup> See Article 9(2).

<sup>26</sup> See Article 18(1) as well as the Model Registry Provisions Article 11(2).

subject to the security right (See Article 34(1) on priority). This is so even if the transferee has no knowledge of the security right. It has been pointed out that a similar result arises under Article 9 of the U.S. Uniform Commercial Code, which has been considered problematic.<sup>27</sup> The ST Model Law would need to be amended if it is thought that cryptocurrencies ought to benefit from rules similar to those for money. In the meantime, the ST Model Law being merely a model, the enacting State may wish to devise special rules for cryptocurrency units to preserve their negotiability.

(c) *Blockchain-based tokens representing negotiable documents*

The ST Model Law contains a set of special rules for “negotiable documents”<sup>28</sup> (e.g. Article 16 on creation, Article 26 on effectiveness against third parties, Article 49 on priority and Article 85(2) on the applicable law). But since “negotiable documents” are supposed to be a tangible asset under the ST Model Law (See Article 2(11)),<sup>29</sup> electronic negotiable documents, including blockchain-based tokens representing negotiable documents, are not subject to the special rules for “negotiable documents.” They instead fall within the concept of “intangible asset”, which is defined as “any movable asset other than a tangible asset” (Article 2(p)). But it is in practice pointless to create a security right in an electronic negotiable document unless it is extended, by virtue of the applicable law, to the tangible asset covered by the document (This indeed is what Article 16 does to “negotiable documents”, *i.e.* paper documents). Furthermore, as a result of the non-applicability of Article 49(3) (a provision for preserving the negotiability of “negotiable documents”<sup>30</sup>), a problem similar to that outlined above in the context of cryptocurrency units would arise with respect to electronic negotiable documents.

To avoid those problems, the enacting State may wish to extend the application of the special rules for “negotiable documents” to electronic negotiable documents. The adoption of the ETR Model Law would have the desired effect so far as the issues are covered by it.<sup>31</sup> This is because the ETR Model Law seeks to bridge the divide between the paper world and the electronic world by extending the application of paper-based rules to an electronic record which satisfies the requirements for functional equivalence to the corresponding “transferable document” as set out in Article 10 of the ETR Model Law (hereafter “qualifying electronic transferable record”). It should be noted that, as examined above, a blockchain-based token, too, can be a qualifying electronic transferable record. It should also be noted that the notion of “transferable documents” under the ETR Model Law largely overlaps with that of “negotiable documents” under the ST Model Law. It follows that a security interest created in a qualifying electronic transferable record would be extended to the tangible asset covered by it by virtue of Article 16 of the ST Model Law. The requirement of “possession” of a “negotiable document” under Articles 26, 49 and 85(2) under the ST Model Law would be met by the “exclusive control” (Article 11 of the ETR Model Law) of a qualifying electronic transferable record. Consequently, Article 49(3) (the provision for preserving the negotiability of “negotiable documents”) would also be applicable to a qualifying electronic transferable record under “exclusive control,” which avoids the problem identified above. But the determination of “the State in which the document is located” under Article 85(2) is not assisted by the ETR Model Law since the latter contains no provision for determining the place in which an electronic negotiable document is deemed to be located.

<sup>27</sup> See e.g. Bob Lawless, “Is UCC Article 9 the Achilles Heel of Bitcoin?” (<http://www.creditslips.org/creditslips/2014/03/is-ucc-article-9-the-achilles-heel-of-bitcoin.html>) (2014); Jeanne Schroeder, “Bitcoin and the Uniform Commercial Code” (2015-2016) 24 U. Miami Bus. L. Rev. 1.

<sup>28</sup> The Model Law contains no definition of this term. According to the Legislative Guide on Secured Transactions, Introduction, para. 20 (p. 10), it means a document, such as a warehouse receipt or a bill of lading, that embodies a right to delivery of tangible assets and satisfies the requirements for negotiability under the law governing negotiable documents.

<sup>29</sup> The Legislative Guide on Secured Transactions, too, was prepared against the background of paper-form negotiable documents (*ibid.*, p. 11 at fn. 25).

<sup>30</sup> See *ibid.*, ch. V, para. 167 (p. 228).

<sup>31</sup> At its 50<sup>th</sup> session (July 2017), the UNCITRAL has decided that the Guide to Enactment of the Model Law on Secured Transactions should state that States adopting both model laws ought to consider their relationships, leaving the States to make their own analysis.

(d) *Blockchain-based tokens representing securities*

Under the ST Model Law, “non-intermediated securities” are securities (*i.e.* shares and bonds)<sup>32</sup> other than those credited to a securities account (Article 2(w)). “Securities account” is in turn defined as meaning an account maintained by an intermediary to which securities may be credited or debited (Article 2(ii)). A blockchain would make it possible to trade securities on a P2P basis and hold them without the involvement of a trusted intermediary. Blockchain-based tokens representing securities (cryptosecurities) would, therefore, be “non-intermediated securities.” They are also unrepresented by a “certificate”, which under the ST Model Law refers only to a tangible document subject to physical possession.<sup>33</sup> It follows that cryptosecurities would fall within the definition of “uncertificated non-intermediated securities” (Article 2(mm)). They would accordingly be subject to special rules for such securities as contained in the ST Model Law (Article 27 on effectiveness against third parties and Article 51 on priority). Thus, a security right in cryptosecurities is made effective against third parties by the conclusion of a control agreement (between the grantor, the secured creditor and the issuer) (See Article 27) and has priority over a security right in the same cryptosecurities for which registration is made in the Registry (See Article 51(3)).

(e) *Use of a blockchain-based distributed-ledger platform as a Registry for security rights*

Under the ST Model Law, the registration of a notice in the Registry renders the security right effective against third parties (Article 18(1)). Can a distributed-ledger platform serve as a Registry?

The ST Model Law contains in Chapter IV a set of rules called “Model Registry Provisions.” Those rules envisage the existence of a registrar who administers the Registry (Article 27). Public blockchains are not administered by any specific person and accordingly would not fit this profile. The administrator of a private blockchain may, on the other hand, be appointed by the enacting State to be a registrar under Article 27. Through the power of appointment and dismissal, the enacting State is ultimately in charge of the Registry’s operation. It would in fact be unlikely for any State to put faith in public blockchains since they are not controlled by any specific entity. Besides, the consensus algorithm of a public blockchain which relies on the “longest chain rule” is incompatible with the provisions in Article 13. The former leaves the possibility that in the event of a fork, records in a chain will be abandoned in favour of those in another chain which eventually becomes longer. The latter, on the other hand, makes the registration of a notice effective when the information in the notice is entered into the Registry record and provides that the information must be entered in the order in which each notice is submitted. With a private blockchain, it should be possible to devise a consensus algorithm compatible with the provisions in Article 13. Furthermore, blockchain ledgers, which are an append-only log, are perfect to fulfil the requirement that the Registry must preserve all information contained in the record (Article 29(2)). It follows that distributed ledgers on a private blockchain platform may serve as a Registry.

5. *Proprietary restitution of blockchain-based tokens*

Having examined the existing works of UNCITRAL, we will now turn our attention to a problem which is untouched by UNCITRAL or any other international organizations. There are a number of circumstances which raise the question whether it is possible to obtain the restitution of blockchain-based tokens by means of proprietary claims. Among the private-law issues arising from the use of the blockchain technology, uncertainty over the availability of such claims seems to be a problem of particular significance. It also calls for a globally unified solution.

What follows will illustrate the problem, outline the legal bases of claims which may be made, and identify the issues involved in such claims. It will then explain why the problem calls for a globally unified solution and consider what approach should be taken to make a uniform law.

<sup>32</sup> See para. 54 of the draft Guide to Enactment (A/CN.9/WG.VI/WP.73).

<sup>33</sup> *Ibid.*, para. 40.

(a) *Illustration of the problem*

The pre-existing forms of electronic money, which are often in the shape of pre-paid cards, provide the holders with credits redeemable from the issuers. Accordingly, most legal problems may be handled under the law of obligations. By contrast, holding cryptocurrency does not by itself entitle the holder to any claim against anybody. Accordingly, proprietary issues become more important.

The significance of proprietary issues is most evident where insolvency hits the holder of cryptocurrency units who, in a variety of circumstances, is under obligation to return the units to another person. That other person may join other creditors in the insolvency proceedings, which would usually yield to him only a partial recovery. But if he could make a proprietary claim to obtain the restitution of the units, he would be able to make a full recovery.<sup>34</sup> The availability of such a claim is, however, currently unclear. The problem arises in a number of circumstances such as those described in Cases 1 to 3 below.

Case 1: Theft of cryptocurrency units.

Suppose that cryptocurrency units have been stolen by means of, for example, malware and then transferred to third parties. The original holder may have a claim in tort for damages covering the value of the stolen units against the thief or against a *mala fide* transferee. But it would not lead to a full recovery in the case of insolvency of the thief or transferee. If the original holder has a proprietary claim for the restitution of the units, he will be able to obtain a full recovery.

Case 2: Mistaken remittance of cryptocurrency units.

Suppose that cryptocurrency units have been mistakenly remitted to a wrong address or in a wrong quantity. The sender may have a personal claim against the recipient in unjust enrichment for the restitution of the value of the units. But it would not lead to a full recovery if the recipient has become insolvent. If the sender has a proprietary claim for the restitution of the units, he will be able to obtain a full recovery.

Case 3: Entrusting of cryptocurrency units to another person.

While the blockchain technology allows cryptocurrency units to be held and traded without the involvement of intermediaries, the users may opt to entrust ancillary service providers with their cryptocurrency units for reasons of convenience. Thus, instead of holding their cryptocurrency units themselves, some may use an online wallet, entrusting their units to the wallet provider. Again, many users of cryptocurrencies buy and sell them through an online exchange and in the course of transactions entrust the exchange provider with their cryptocurrency units. These customers would have a contractual claim for the return of their cryptocurrency units or their value from the provider of wallet or exchange. But it would not lead to a full recovery if the provider becomes insolvent. If the customer has a proprietary claim for the restitution of the units, he will be able to obtain a full recovery.

There is a real case in point. Mt.Gox was once the world's biggest provider of a Bitcoin exchange. It became insolvent and entered into winding-up proceedings. Most of the creditors were its former customers who had entrusted it with bitcoins and/or fiat currencies. One of them filed a suit against the insolvency representative, seeking a full recovery of the bitcoin units of which, or the value of which, he had a contractual right to return from Mt.Gox. He did so by asserting ownership over them rather than making a personal contractual claim.<sup>35</sup>

The proprietary issues also have practical significance outside the context of insolvency. Thus, if cryptocurrency units have been seized by a creditor of the holder, the person who has a proprietary claim

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<sup>34</sup> It should be noted that for creditors who have no proprietary claim for restitution, there remains the possibility of obtaining priority over other creditors conferred by a statutory lien.

<sup>35</sup> For the outcome of the case, see *infra* ch. 0.

for the restitution of the units would be able to challenge the seizure. Such situations can also arise from a number of circumstances including those described in Cases 1 to 3 above.

The significance of the proprietary issues extends beyond cryptocurrencies to non-monetary tokens which may be traded and held on a blockchain, such as those representing securities (cryptosecurities),<sup>36</sup> those for controlling domain names and those used in an ICO (Initial Coin Offering).<sup>37</sup> Circumstances analogous to those described in Cases 1 to 3 above will raise the question whether it is possible to obtain their restitution by means of proprietary claims.

*(b) Legal bases of proprietary claims for restitution*

A proprietary restitutionary claim may most obviously be based on ownership. The legal systems which have inherited the Roman law concept of ownership, *dominium*, would allow an action to be filed for *rei vindicatio* (vindication of property: an owner's claim against the possessor for the return of the property)<sup>38</sup> which may be made outside insolvency proceedings. The plaintiff's claim in the Mt.Gox case outlined above falls within this category.

For other legal systems, notably common law systems, *rei vindicatio* is an alien concept. Thus, in the English common law, the tort of conversion fills the gap of the missing *vindicatio*. Although nominally tortious, it has become the remedy to protect the ownership of goods.<sup>39</sup> The delivery of the goods may be ordered at the discretion of the court,<sup>40</sup> which will be exercised where the defendant is insolvent.<sup>41</sup>

In some legal systems, a proprietary restitutionary claim may alternatively be made on the basis of a resulting or constructive trust. Where the claimant can show that he has an equitable proprietary interest in property that is in the possession of the defendant, the court may declare that the property is held on trust for the claimant and it will order the defendant to transfer this property in specie to the claimant.<sup>42</sup> Many claims to a resulting or constructive trust are motivated by the principle that property held by the bankrupt on trust for another person does not form part of the bankrupt's estate.<sup>43</sup> Thus, in *Re Goldcorp Exchange Ltd*,<sup>44</sup> a dealer in gold became insolvent and its customers sought a declaration that the dealer had held bullion on trust for them. In another case, *Chase Manhattan v. Israel-British Bank*,<sup>45</sup> a transfer of a dollar-denominated bank deposit was made in error and the transferee was subsequently wound up. The transferor sought a declaration that the transferee had become a trustee of the paid sum for the transferor. It can be anticipated that a claim to a resulting or constructive trust will be triggered to obtain the restitution of blockchain-based tokens in such circumstances as those described in Cases 1 to 3 above.

*(c) Issues involved in the claims of different legal bases*

Where an ownership-based *vindicatio* claim is made to seek the restitution of blockchain-based tokens, the first issue which must be addressed is whether such tokens qualify to be an object of ownership. Thus,

<sup>36</sup> See e.g. Philipp Paech, "Securities, intermediation and the blockchain: an inevitable choice between liquidity and legal certainty?" (2016) 21(4) *Unif Law Rev* 612, 637.

<sup>37</sup> It is a means of raising capital which IT start-ups have begun to use. They issue and sell coins (tokens) on a blockchain which entitle the holders to receive services and dividends from them. Besides the private-law issues examined by this article, this method raises regulatory issues: See e.g. the U.S. Securities and Exchange Commission, "Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO" (Release No. 81207 / July 25, 2017).

<sup>38</sup> e.g. section 985 of the German BGB (Civil Code).

<sup>39</sup> *OBG Ltd v Allan* [2007] UKHL 21, para. 308 (House of Lords). See also Andrew Burrows (ed.) *English Private Law* (3<sup>rd</sup> ed., 2013) paras. 17.304 and 17.309 [Donal Nolan and John Davies].

<sup>40</sup> Torts (Interference with Goods) Act 1977, s 3.

<sup>41</sup> See Richard Calnan, *Proprietary Rights and Insolvency* (2<sup>nd</sup> ed., 2016) para. 2.108.

<sup>42</sup> See e.g. *Boscawen v Bajwa* [1996] 1 WLR 328, 335 (English Court of Appeal); *Giumelli v Giumelli* (1999) 196 CLR 101 [3] (High Court of Australia).

<sup>43</sup> Andrew Burrows (ed.) *English Private Law* (3<sup>rd</sup> ed., 2013) para. 4.152 [William Swadling].

<sup>44</sup> [1995] 1 AC 74 (Privy Council).

<sup>45</sup> [1981] Ch 105 (English High Court).

in the Mt.Gox case outlined above, the Tokyo District Court dismissed the claim by denying that bitcoin units could be an object of ownership.<sup>46</sup> The court's reasoning rested on a formal analysis as it relied on the Japanese law concept of "*shoyūken*," a concept which signifies ownership but is statutorily limited to tangibles as its objects. Some legal systems, like Japanese law, restrict the object of ownership to tangibles while others extend it to intangibles.<sup>47</sup> In the systems which belong to the latter camp, the exact category of intangibles which qualify as an object of ownership may not be set in stone. In the legal systems which currently restricts the object of ownership to tangibles, whether the law should remain static is another question. The blockchain-based tokens may compel the legislature and judiciary in each State to consider *de lege ferenda* (with a view to the future law) whether their concept of ownership should embrace them.<sup>48</sup>

A case may be made for treating certain kinds of them as being an object of ownership by distinguishing them from other digital assets or data on account of, *inter alia*, their amenability to exclusive control by the holders.<sup>49</sup>

The same issue will arise where the restitution of blockchain-based tokens is claimed in tort of conversion.<sup>50</sup> It has been litigated whether the remedy of conversion is available to protect intangibles such as choses in action,<sup>51</sup> information in a database<sup>52</sup> and domain names.<sup>53</sup> The blockchain-based tokens will be a latest addition to this list.

If blockchain-based tokens, or certain kinds of them, qualify to be an object of ownership, the next question to be addressed is what should be the test for determining the owner. It would accord with the intuition of many users of such tokens to consider that the holder of the private key for the address at which tokens are held owns them. This intuition presumably stems from the fact that the holder of the private key has an exclusive control over the tokens. But the rule cannot be as simple. For one thing, there are situations which require an elaboration of what it means to be the holder of a private key as where the private key has been intentionally or accidentally disclosed to two or more persons. For another, there may be circumstances in which it is thought that an ownership-based claim for the restitution of tokens should be allowed against the present holder. Each of the circumstances described in Cases 1 to 3 above merits consideration in this light. Thus, the case for allowing such a claim may be considered to be stronger where the holder is a thief (Case 1) or an online wallet provider (Case 3) than in other situations. Such circumstances as described by Cases 1 and 2 would also raise the questions whether the *nemo dat* rule (that no one can give a better title than he himself has) should prevail and when exceptions, if any, should be made.<sup>54</sup>

<sup>46</sup> The judgment of the Tokyo District Court on 5 August 2015 (2015WLJPCA08058001).

<sup>47</sup> Akkermans classifies German and Dutch laws into the former category, while French law in the latter (Bram Akkermans "Property Law" in Jaap Hage & Bram Akkermans (ed.) *Introduction to Law* (2014) 71, 78). Von Bar and Drobnig add Greek law to the former camp and the laws of Portugal, Italy, Austria, Belgium, Spain, Sweden, and Scotland to the latter (Christian von Bar and Ulrich Drobnig, *The Interaction of Contract Law and Tort and Property Law in Europe A Comparative Study* (2004) 317).

<sup>48</sup> For academic discussions, see e.g. Shawn Bayern, "Dynamic Common Law and Technological Change: The Classification of Bitcoin" 71 Wash & Lee L Rev Online (2014) 22, 34; Joshua Fairfield, "BitProperty" 88 S. Cal. L. Rev. 805 (2015); David Quest, "Taking security over bitcoins and other virtual currency" (2015) 7 JIBFL 401; Matthew Lavy & Daniel Khoo, "Who Owns Blockchains? An English Legal Analysis" (<http://sclbc.zehuti.co.uk/site.aspx?i=ed47875> (2016)).

<sup>49</sup> It should be noted by way of contrast that the digital assets of an online game disappear if the provider of the game erases the data on its server.

<sup>50</sup> Sjef van Erp, "Comparative Property Law" in Mathias Reimann & Reinhard Zimmermann (eds), *Oxford Handbook of Comparative Law* (2006) 1044 at 1062, notes that what qualifies as an object of property law is a fundamental property law question which is as pressing in the civil law systems as in the common law systems. The author cites domain names, the right to use a wireless network and emissions quota as examples of possible new objects.

<sup>51</sup> *OBG v Allan* [2007] UKHL 21 (House of Lords).

<sup>52</sup> *Your Response Limited* [2014] EWCA Civ 281 (English Court of Appeal).

<sup>53</sup> *Kremen v Cohen*, 337 F 3d 1024 (2003) (U.S. Court of Appeals for the Ninth Circuit).

<sup>54</sup> For a consideration under English law, see Joanna Perkins and Jennifer Enwezor, "The legal aspect of virtual currencies" [2016] 10 JIBFL 569.

Where a proprietary claim arising from a resulting or constructive trust is made to seek the restitution of blockchain-based tokens, it is not necessary to consider whether such tokens can be an object of ownership in the sense of a source of *vindictio* claim. Intangible assets are capable of being trust property<sup>55</sup> and so will be blockchain-based tokens. But another issue, no less difficult, will arise: under what circumstances the holder of blockchain-based tokens is deemed to hold them on trust for the claimant.

Whether the claim for restitution is based on ownership or arises from a resulting or constructive trust, it gives rise to the additional question, namely in what way the tokens must be identified. If specific identification were required, it would have to be possible to technically trace the tokens of which restitution is sought. The transactions of blockchain-based tokens are traceable since they are recorded immutably in the blockchain. This should make the task of identification of blockchain-based tokens easier than would be the case with tangible goods. It should, however, be noted that while transactions are traceable on a blockchain, tokens are less so unless they are individually coloured. Consequently, it will often be difficult to specifically identify the tokens of which restitution is sought. It is important, however, to realise that what matters in law is not technical traceability but normative traceability. To affirm normative traceability, it may be enough to be able to say that the person from whom the restitution is sought could be deemed to hold all or part of the units of which the restitution is sought. To illustrate the point by an easy case, suppose that Alice had 70 units at her address. Bob has stolen them through a phishing attack and transferred them to his address in which they have been mixed up with the 30 units he had held there. Unless the stolen 70 units had been coloured, it will not be technically possible to say which of the 100 units Bob now holds at his address are originally Alice's. It is, however, possible to say that Bob holds the stolen 70 units. The question will certainly become more difficult if Bob makes a transfer from his address. But it may be possible to normatively trace the stolen units up to some point.

*(d) Why the problem calls for a globally unified solution*

If each national legal system is left to its own device, divergent positions may emerge over each of the issues examined above. Thus, legal systems may come to differ as to whether blockchain-based tokens qualify as an object of ownership and what are the tests for determining owners. Although legal uncertainty arising from divergence among national laws may be mitigated if the governing law is predictable, it is not clear for reasons examined below what law governs proprietary claims for the restitution of tokens on a public blockchain. The lack of clarity and predictability of governing law, coupled with the novelty and practical significance of the problem, makes a strong case for a globally unified solution.

New issues of contract law, by contrast, do not immediately call for a globally unified solution. Rather, there is a lot to be said for leaving them to be dealt with by each domestic law for the time being. This is because party autonomy is well established as a principle of choice of law for contractual issues.<sup>56</sup> It allows contracting parties to choose the legal systems which they find will provide the best rules for their contract. This provides legal certainty for the parties and may at the same time motivate the national law makers to compete with each other with a view to making their legal system attractive for parties' choice. When favoured rules eventually emerge, an international unification may then be attempted along such rules.

For proprietary issues, party autonomy is generally not accepted as a choice-of-law principle. In the first place, it is unworkable between the parties whose relationships are not contractual except to the extent *ex post* (after the event) choice is permitted. Furthermore, the freedom of parties to choose the governing law by agreement can produce the fragmentation of governing law among different pairs of parties. Such a result might not be seen so unpalatable in the eyes of some legal systems, typically common law systems, which handle proprietary questions relatively, namely by asking which of the two competing litigants has the better right. On the other hand, the legal systems which have inherited the Roman law concept of

<sup>55</sup> With respect to an emissions quota, see *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10. More generally, equitable property interests can be created over assets which the common law does not regard as property: See Calnan, *supra* note 41, para. 2.69.

<sup>56</sup> As reflected in Article 2 of the Hague Principles on Choice of Law in International Commercial Contracts, a text which has been endorsed by UNCITRAL (Report of the 48th session (2015) A/70/17 para. 240).



ownership, *dominium*, would favour the absolute exclusivity, or the *erga omnes* (“towards everyone”) effect, of ownership. It is true that this conceptual absoluteness tolerates some relativism to creep in at the evidential level due to difficulties of proof:<sup>57</sup> since the perfect proof of ownership tracing up all prior transactions to the first owner would be difficult or impossible, it is described as a devil’s proof (“*probatio diabolica*”). At the choice-of-law level, however, it makes more sense to specify a single law for determining ownership irrespective of who, among a number of stakeholders, are the litigants in a particular case.

With respect to tangible goods, it is well established that proprietary issues are governed by the law of the country where it is situated (*lex situs*). With respect to intangibles, of which blockchain-based tokens are an example, choice-of-law rules are far from settled. With respect to an emissions quota, which is financially valuable data like a blockchain-based token, it has been suggested that the proprietary issues should be subject to the law of the country where it is registered.<sup>58</sup> This connecting factor does not work with a blockchain-based token since it is not registered on a national registry. Where a consortium blockchain is used, it may be possible to ascertain the law of the country with which it is most closely connected by having regard to the country in which it is administered. On the other hand, a public blockchain is not administered by any specific entity and the tokens are recorded on ledgers which are distributed on a borderless network. This makes it difficult to localize tokens on a public blockchain and consequently renders the governing law of their ownership unclear.

The same problem of uncertainty exists where a restitutionary claim is made for the tort of conversion. It has been suggested that the claim should be characterized as proprietary for choice-of-law purposes since, although it is nominally tortious, property rights are ultimately at stake.<sup>59</sup> As seen above, this characterization does not lead to clear choice-of-law rules where tokens on a public blockchain are the object of the claim.

The governing law of a proprietary restitutionary claim arising from a resulting or constructive trust is no clearer. Some have argued that it should be specified by the choice-of-law rules for unjust enrichment<sup>60</sup> on the ground that constructive trusts arise in response to unjust enrichment.<sup>61</sup> Others have argued that the proper characterisation is proprietary on the ground that the issue of whether property is impressed with a trust lies at the heart of such a claim.<sup>62</sup> Whichever characterization is adopted, the governing law is not clear where tokens on a public blockchain are the object of the claim. Thus, we have seen above that the proprietary characterization would not lead to clear choice-of-law rules. The characterization of unjust enrichment would result in the application of the law of the place of enrichment.<sup>63</sup> In the case of transfer to an address on a public blockchain, the place of enrichment is unclear since the blockchain is borderless. This may be contrasted with the case of transfer of deposit to a bank account. The place of enrichment would then be easily identifiable through the geographical location of the branch office with which the account is held.

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<sup>57</sup> Peter Birks, “The Roman Law Concept of Dominium and the Idea of Absolute Ownership” (1985) *Acta Juridica* 1, 28.

<sup>58</sup> Koji Takahashi, “Conflict of Laws in Emissions Trading” (2011) 13 *Yearbook of Private International Law* 145.

<sup>59</sup> James Fawcett & Janeen Carruthers, *Cheshire, North & Fawcett Private International Law* (14<sup>th</sup> ed., 2008) 794 and 821.

<sup>60</sup> This characterisation seems, however, unsupportable in the context of the Rome II Regulation which contains rules for unjust enrichment (Article 10) because its full title (Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations) indicates that it is concerned with personal remedies rather than proprietary remedies. See e.g. Adeline Chong, “Choice of Law for Unjust Enrichment/Restitution and the Rome II Regulation” (2008) 57 *ICLQ* 863. For a contrary view, see e.g. Peter Huber (ed.) *Rome II Regulation* (2011) Art. 1 para. 26 [Ivo Bach].

<sup>61</sup> See e.g. George Panagopoulos, *Restitution in Private International Law* (2000) 70.

<sup>62</sup> See e.g. Adeline Chong, “The Common Law Choice of Law Rules for Resulting and Constructive Trusts” (2005) 54 *ICLQ* 855.

<sup>63</sup> See *Christopher v Zimmerman* (2001) 192 *DLR* (4th) 476 (British Columbia Court of Appeal).

(e) *Approach to a uniform law making*

We have seen above various circumstances in which proprietary claims may be made to obtain the restitution of blockchain-based tokens. We have found that uncertainty over the availability of such claims is a significant problem. We have further seen a strong case for devising a globally unified solution to that problem. A globally unified solution may be formulated by an instrument in the form of a convention or model law. We will now consider what should be the approach to making a uniform law instrument.

As we have seen, there are divergent legal bases on which proprietary restitutionary claims may be made under the existing legal systems. Thus, some legal systems allow a claim for *rei vindicatio* based on ownership while others require a similar claim to be framed in the tort of conversion. Some legal systems know the principle of a resulting or constructive trust while others do not. It follows that if a uniform law uses the expression of *rei vindicatio*, it risks alienating States in whose legal systems this concept is unknown. The same is true if a uniform law uses any other terms of art such as the tort of conversion, resulting trust and constructive trust. A uniform law should instead choose neutral terms or, in their absence, use terms in a non-technical sense. Thus, if the English word “ownership” is used, care should be taken not to equate it with a notion of any particular legal system such as the French *propriété*,<sup>64</sup> German *Eigentum*,<sup>65</sup> Japanese *shoyūken*<sup>66</sup> and indeed the English law concept of ownership.<sup>67</sup> Again, if the expression “proprietary restitutionary claim” is used, the uniform law should steer clear of the dogmatic debate in English law over whether its cause of action is unjust enrichment or the vindication of a property right.<sup>68</sup> This stance would also accommodate the legal systems, typically civil law systems, which do not grant proprietary remedies in response to unjust enrichment.<sup>69</sup>

By choosing neutral terms or using terms in a non-technical sense, a uniform law can avoid getting mired in doctrinal debates prevailing in the existing legal systems. There is indeed no need for a uniform law to address the issues involved in the claims of different legal bases as identified in the foregoing analysis, at any event in the context of the specific domestic legal systems in which they arise. Thus, it is not the task of a uniform law to address whether, for example, the Japanese law concept of *shoyūken* should cover bitcoin units. What a uniform law instead should do is to prescribe the results for a selection of circumstances which each legal system should produce.<sup>70</sup> It should thus address whether proprietary restitution should be permitted in such circumstances as those described in Cases 1 to 3 above. Even if it should happen that after a careful consideration, the drafters decide not to grant proprietary restitution in any of such circumstances, it would still be better to enunciate the position than leaving it uncertain.

Once a uniform law has been formulated, the enacting States have options: either (1) work out how to reconcile the prescribed results with its existing legal framework or (2) introduce the uniform law as containing a *sui generis* framework. The option (2) would be difficult if the existing law had already produced legislation or a body of case law on the subject matter. But it may be a viable option with respect to a novel asset like blockchain-based tokens.

Finally, it will be necessary to say a few words about execution procedure. When it comes to the execution of a decision allowing a proprietary claim for the restitution of blockchain-based tokens, it will be necessary to have them transferred to the successful claimant by way of obtaining the private key. The

<sup>64</sup> Article 544 of the French Code civil.

<sup>65</sup> Section 903 of the German BGB (Civil Code).

<sup>66</sup> Article 206 of the Minpo (Japanese Civil Code).

<sup>67</sup> It is an elusive concept but is conventionally defined as the residue of legal rights in an asset remaining in a person after specific rights over the asset have been granted to others. See Ewan McKendrick & Roy Goode, *Goode on Commercial Law* (4<sup>th</sup> ed. 2010) 34.

<sup>68</sup> See e.g. Graham Virgo, *The Principles of the Law of Restitution* (3<sup>rd</sup> ed., 2015) 7.

<sup>69</sup> George Panagopoulos, *Restitution in Private International Law* (2000) 61.

<sup>70</sup> This approach to a uniform law making is described as a functional approach and favoured by Hideki Kanda, “Methodology of Harmonization and Modernization of Legal Rules on Secured Transactions -- Legal, Functional or Otherwise?” (a paper delivered at the UNCITRAL Fourth International Colloquium on Secured Transactions (2017), available at the UNCITRAL website).

process may encounter difficulties where the defendant resists disclosing the key. In some legal systems, a compulsory mechanism such as the threat of sanctions for contempt of court may be available to compel disclosure. Where the key is stored in a tangible medium such as a hard disc or paper, the seizure of the medium may be possible under some legal systems. It would not be necessary for a uniform law to harmonise this aspect of law since, as with other procedural issues, the method of execution may be left to the *lex fori*, i.e. the law of the place where the procedure is to be taken.

## 6. Concluding remarks

The legal issues which we have examined above are diverse. Some of them concern the use of distributed ledgers generated by the blockchain technology such as the legal effects of data messages recorded therein. As well as generating distributed ledgers, the blockchain technology makes it possible to trade tokens online on a P2P basis and hold them without the involvement of intermediaries. Those tokens are an object of unprecedented type. Thus, bitcoin units, for example, only exist conceptually as an entry in a blockchain address. They cannot be copied or stored in a tangible medium since there is no such thing as a string of alphanumeric characters for each of the units: what can be stored is rather the private keys to reassign them.<sup>71</sup> Such unique features<sup>72</sup> of blockchain-based tokens are a rich source of novel legal issues.

In the first half of this article, we have examined the existing UNCITRAL works to see what legal issues raised by the blockchain technology may be resolved under them. With principles such as those of technological neutrality and functional equivalence, the existing works are flexible enough to accommodate the blockchain technology. While there are a few unanticipated issues which the technology raises, they may be dealt with by further developing those works.

In the second half of the article, we have examined the circumstances which raise the question whether it is possible to obtain the restitution of blockchain-based tokens by means of proprietary claims. Among the private-law issues arising from the use of the blockchain technology, the uncertainty over the availability of such claims is a problem of particular significance. It also calls for a globally unified solution but is untouched by the existing works of UNCITRAL or any other international organization. UNCITRAL has a rich experience in the areas of particular relevance such as electronic commerce, insolvency and security interests. It also has a good record of respecting the divergence of existing legal frameworks while at the same time working towards harmonization. All this makes UNCITRAL an ideal and the natural forum for providing a globally unified solution to the problem identified.

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<sup>71</sup> Antony Lewis, “A gentle introduction to digital tokens” (<https://bitsonblocks.net/2015/09/28/a-gentle-introduction-to-digital-tokens/>).

<sup>72</sup> Perkins & Enwezor, *supra* note 54, see certain virtual currencies as a new form of property under English law as they share characteristics of both intangible property and choses in possession.

*Lost and found in smart contract translation —  
considerations in transitioning to automation in legal architecture*<sup>1</sup>

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“Smart contracts” can be different things to different people, from a theoretical term for self-executing computer code, to legal contracts which use automated processes to ensure performance. The relevance of smart contracts has evolved since their conception. The development of blockchain and other distributed ledger technology has enabled more sophisticated use of smart contracts, supporting their evolution from a theoretical possibility to a practical reality.

The transition to automation in legal architecture through smart contracts should improve transactional productivity, efficiency and risk management. However, this transition also involves a translation of legal rights, obligations and remedies into a framework which is, at least partly, digital. It is critical that this translation is conducted carefully, so that nothing is unknowingly lost with the change in expression. Further, it gives rise to issues of legal recognition which do not arise for traditional contractual frameworks and to which harmonized cross-border solutions need to be found.

In this paper, we set out what smart contracts are, legal considerations in their creation and issues of legal recognition and harmonization which need to be considered further if the potential for these contracts to transform cross-border trade and finance is to be achieved.

### *1. Smarter contracts*

The term “smart contracts” is not new. Early references to “smart contracts” can be found in data and computer science papers from the late 20<sup>th</sup> Century. In 1996 Nick Szabo described smart contracts as being:

*“a set of promises, specified in digital form, including protocols within which the parties perform on the other promises.”*<sup>3</sup>

In other words, a digitally executable set of obligations which requires minimal external inputs to ensure performance. The architecture of the smart contract automates the performance of obligations. However, these smart contracts are more than mere automated processes for enabling performance, they also have the means of ensuring the performance.<sup>4</sup> Accordingly, there is confidence that the transaction can be completed. This is sometimes referred to as “tamper-proof” execution. It is this ability to perform “on its own” which makes the contract “smart”. However, despite their name, these smart contracts may be created only as processes for effecting transactions and it may not be integral to their design that they have any recognition at law.

The connection between smart contracts and legal contracts has arisen as new technology has allowed use of smart contracts to be expanded into more complex transactions and relationships. Blockchain and other distributed ledger technology has permitted smart contracts to be applied to a broader architecture where digital assets and digital value can both be maintained. In this more complex architecture, self-

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<sup>1</sup> This paper in part draws on the remarks made to the combined meeting of the Financial Stability Board and the Committee of Payments and Market Infrastructure on Uses of Distributed Ledger Technology in Financial Markets and Issues for Financial Authorities at the Bank of England on 21 October 2016 and to the 2016 UNCITRAL Emergence Conference Regional Perspectives on Contemporary and Future Harmonization Agenda in International Trade Law on 13-14 December 2016, in each case by Scott Farrell.

<sup>2</sup> Scott Farrell is a member of the Australian Government’s FinTech Advisory Group. However, none of the comments made in this paper should be taken to have been provided in this capacity.

<sup>3</sup> Szabo, *Smart Contracts: Building Blocks for Digital Markets*, 1996.

<sup>4</sup> An example of this is a vending machine which completes transactions automatically by delivering the item purchased once the payment has been made. Completion of this transaction requires no input from the owner of the machine. Instead, the architecture of the system controls the timing and the manner of the parties’ performance.

executing computer code can be used to effect transactions, exchanging the digital assets for digital payments. This has allowed smart contracts to be applied in a broader range of transactions, including those where legal enforceability is as important as operational execution. Some early definitions of smart contracts are not able to describe this expanded application, particularly as some parts of those transactions are too complex to be automated. A revised definition of smart contract is warranted, and one has been supplied by Clack, Bakshi and Braine:

*“A smart contract is an agreement whose execution is both automatable and enforceable. Automatable by computer, although some parts may require human input and control. Enforceable by either legal enforcement of rights and obligations or tamper-proof execution.”*<sup>5</sup>

This definition defines a contract to be a smart contract if at least *some parts* can be performed by a computer programme automatically, without human input, *whilst also* being enforceable either through the appropriate legal system or because the execution of the obligations by the computer cannot be undone. It is a contract which is effective either through self-execution of computer code or legal force. The coded contract and the legal contract are linked. This linkage between computer code and law is the basis for the issues discussed in this paper.

Before considering those issues, it is worth describing why smart contracts warrant consideration. In summary, it is because they improve the efficiency, speed and performance of contracts. Efficiency is improved because of the automation of contractual actions, which reduces the need for human involvement and, as a result, the potential for human error. Speed is improved as actions can occur in real time as information is collected and verified. Performance is improved as the terms are unambiguous and results predictable and auditable. This has the potential to reduce the risk of disputes. These factors are similar to those which drive the use of financial market infrastructure for critical transactions. Indeed, when appropriately used with distributed ledger technology, smart contracts have the ability to perform the same functions as centralised financial market infrastructure — which is particularly important for those transactions where such infrastructure is not currently available, or impossible to obtain.<sup>6</sup>

It is fundamental to a legal examination of smart contracts to consider whether it is possible for a contract which is set out in computer code to be valid at law. This is considered in the next section.

## 2. *A contract in code*

As described above, a smart contract achieves efficiency, timing and performance improvements because of automation of the contract's terms. This automation is effected through the computer code which governs the automated performance. This raises a critical issue — whether contractual provisions which are expressed in computer code can be valid and effective under law. This is sometimes regarded as a difficult hurdle to clear for the widespread use of smart contracts in complex and regulated areas, such as finance. Often this issue is considered in the context of a contract which is expressed entirely in computer code. In such cases, basic contractual formation issues can cause concerns, such as the identity of parties, the identification of terms, the time of creation and the governing law.

However, before considering these issues, it is important to keep in mind that not all of a smart contract needs to be set out in code. Some terms of contracts which are more complex than the immediate transfer of value and property are likely to not be efficiently encoded. This is because computer code (like mathematics) is well adapted to represent terms which are expressions of logic but not terms which are based in concepts such as reason or conscience. Further, they are not useful to represent terms which are based on the exercise of discretion that is outside of clearly defined frameworks.

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<sup>5</sup> Clack, Bakshi and Braine, *Smart Contract Templates: foundations, design landscape and research directions*, 2016.

<sup>6</sup> This comparison is considered further in section 5 of this paper.

For example, code could be used to represent the contractual agreement that, if an event happened:

*“the price is to be adjusted by subtracting the product of x and y.”*

This provision can be coded easily because it is an expression of logic. However, code would not be useful to accurately represent that, if an event happened:

*“the price is to be adjusted by the party in a commercially reasonable manner.”*

Or:

*“the price is to be adjusted by negotiation between the parties in good faith.”*

These two provisions are based in the exercise of reason, conscience and discretion in the future. They cannot be easily coded because their meaning is not able to be comprehensively expressed as a matter of logic. An attempt to do so would create the risk of *divergence* expressed in natural language between the meaning of the original contractual provision and its expression in code.

Real commercial and financial contracts are a mixture of contractual provisions based in logic, reason, conscience and discretion. Accordingly, there are a mixture of provisions which are able to be efficiently coded and those which are not. It follows from this that if smart contracts are to be used meaningfully in commercial contracts then they will need to be blends of both coded and natural language terms. As the logical provisions are usually applicable during the normal life-cycle of contracts (as opposed to the provisions which apply when unexpected events occur) then this is where the most efficiency should be obtained from using coded terms.<sup>7</sup>

This context changes the nature of the fundamental legal issue with contracts expressed in code. As complex contracts will need to be blends of natural language and code the primary concern is no longer whether a contract can be created because the natural language elements of the contract should be able to satisfy these requirements. Instead, the concern should be whether a contract can be valid if part of it is expressed in natural language and part in computer code. An alternative to a blend of coded and natural language terms is to retain the entire contract in natural language and use code to separately perform those terms. However, this duplication creates the risk of a discrepancy, the risk that the actions being performed by the code do not match the legal meaning of the natural language contract.

This is an area where local laws will be particularly relevant and there is a role for harmonisation of those laws to facilitate cross-border transactions. Key issues for consideration include:

- ***Legitimacy of multilingual contracts.*** In one sense, a contract which includes provisions which are expressed in code is similar to a contract which includes provisions which are expressed in different languages. If contracts which are expressed in more than one language are not effective under local laws, then it is likely that contracts expressed partly in code and partly in natural language may not be effective either.
- ***Understanding of coded terms.*** If a contract is partly expressed in code then the understanding of that code by the parties is relevant. This relevance can be a matter of regulation, such as whether particular parties (such as consumers) can be bound by terms which they do not understand, or it can be a matter of fundamental contract law, such as whether there was sufficient mutual understanding of the terms to form the contract at all.

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<sup>7</sup> This separation in contractual architecture between provisions applicable in the ordinary life-cycle of transactions and those applicable in other circumstances can be best seen in the contractual frameworks used in the international derivatives market. Life-cycles provisions are contained in transaction confirmations whilst other provisions are contained in the master agreements which govern them.

- **Evidence of coded terms.** Even though the parties can agree to express specific terms of their relationship in computer code, it is important that that expression is admissible in any judicial and arbitrary proceedings which arise out of that relationship. An inability to admit this record of the parties' agreement would impair its legal effectiveness.

These issues can be seen in context if the circumstances are changed only slightly, by replacing the reference to provisions expressed in code with provisions expressed in a foreign language. If part of a contract was to be performed in a foreign country then it could be more efficient to express that part of the contract in the language of that foreign country, so that the people having to perform can understand the terms in their own language. Each of the issues described above would also apply to such a bi-lingual contract. Hopefully, they are able to be solved under local laws in exactly the same way.<sup>8</sup> Whatever the solution reached under local laws, there would need to be consistency across jurisdictions which seek to be involved in an international smart contract marketplace.

Of course, there is a difference between the creation of a smart contract comprised of both natural language and coded terms and ensuring its enforceability. The self-executing nature of the coded provisions does not guarantee their effectiveness at law. This is because the law does not accept that everything which has been done must have been lawful. The fact that the terms are in code, does not mean that the code has become the law. This is discussed in the next section of this paper.

### 3. *The code is not law*

The effect of self-executing performance of smart contracts has been described as “the code is law”, because the coded provisions have effect without external input or control.<sup>9</sup> However, this is usually not intended to be a comment on the applicability of the law. Of course, smart contracts do not change or replace law and the law still applies to a smart contract regardless of the code.<sup>10</sup> This means that a key issue in translating contracts into smart contracts is to determine which laws need to be contemplated in the smart contract design, because they will apply regardless of the smart contract's code. Building this into the smart contract architecture allows the smart contract to work with the law, instead of trying to work against it. Two categories of such laws are those which interrupt or reverse performance and those which change the contract's terms.

#### *Laws which interrupt or reverse contractual performance*

Laws can interrupt the performance of contracts, or cause the reversal of performance of contracts, for different reasons. In essence, these laws have this effect because they express the public policy that the result of interrupting or reversing the parties' private contract is more important than compelling those parties to fulfil their obligations under that contract in accordance with its terms. It is not possible to contract out of these laws; they apply regardless of its terms or its performance. Accordingly, it is not possible to “code” out of these laws either.

One example are laws which render obligations under a contract to be void or voidable. This can happen because of the insolvency or bankruptcy of one of the parties, the contract is found to be unauthorized, improper or fraudulent or the purpose of the contract, or the conduct of the parties is contrary to regulation or otherwise unlawful. If a smart contract contains coded terms which effect payments and deliveries between the parties over a period of time then those terms could conflict with those laws (for

<sup>8</sup> Assuming the local law is meant to be technologically neutral.

<sup>9</sup> Indeed, that is the very expression used by some leading commentators, such as Lawrence Lessig. Lessig's original work was in fact called *The Code is Law and other laws of cyberspace* (1999). Lessig published a second edition of this in 2006 called *Code 2.0*.

<sup>10</sup> This point was expressly noted by Lessig. In *Code 2.0* Lessig notes: “Of course, for the computer scientist codes is law.” but “Code is not law, any more than the design of an airplane is law. Code does not regulate, any more than buildings regulate. Code is not public, any more than a television is public.” Another way of expressing could be that code is law for machines, but law is code for legal entities. They each work in different frameworks.

example, if one of the parties becomes insolvent before all of those payments and deliveries have been made).

If the smart contract is to remain efficient, it is important that it is sufficiently flexible in order to operate in compliance with these laws. This is particularly the case where the technology on which the coded parts of the smart contract operate is, from a technology perspective, immutable. This would be the case for smart contracts held on a blockchain or other distributed ledger technology.<sup>11</sup> In these circumstances, there needs to be included in the smart contract architecture a method for relieving the contract from the constraints of that technology. If there is a difficulty with including this in the coded terms then the flexibility could be provided through the natural language provisions which also form part of the smart contract.

Importantly, this is not a question of changing those laws so that they do not impact on smart contracts. The laws exist to achieve a policy outcome which is deemed more important than individual contract certainty. This should apply equally to traditional contracts and smart contracts (technological neutrality works “both ways”). What is important from an efficiency perspective is that the contract is designed so it has a means to operate other than in conflict with such laws.

#### *Laws which change contractual terms*

Laws can also change the terms of a contract. This can happen by terms being implied by law (such as under consumer protection legislation), terms being found void and removed, or even by rectification if a court finds that the terms do not reflect the true agreement between the parties.

This is also a significant consideration in translating contractual provisions into a “smart” form. If a subsequent change in terms required by law is not able to be included in the operation of a smart contract, then there is a significant risk that the automated performance of the contract will not be consistent with the terms of the real agreement between the parties — there will be a risk of a “discrepancy” between agreement and performance.

Theoretically, it is possible for the coded terms of a smart contract to be drafted so as to automatically respond to certain laws. For example, Marino and Juels<sup>12</sup> have proposed the inclusion of standards in smart contracts dealing with rescission by court, which have the effect of halting automatic performance of the smart contract if an order is made by an appropriate court, and providing for the contract to automatically compensate partial performance. However, given the immense complexity of laws and potential factual circumstances, it would not be feasible, nor computationally efficient, to include such automated standards covering all potentially applicable laws and events, particularly where the underlying transaction or surrounding facts are complicated.

Accordingly, it is also important from an efficiency perspective that the design of the smart contract is sufficiently flexible to be able to respond to a change in its terms imposed by law without creating an unavoidable discrepancy between those terms and its automated performance.

#### *Flexing the code*

It is noted above that smart contracts need to be designed with sufficient flexibility to work with the laws which will apply to them, and to other contracts. However, this need for flexibility in a smart contract can compete with the certainty provided by the coded parts of that contract. The efficiency of a smart contract arises from its automatic operation and there are practical limits to the flexibility which can be included in such automation. Current technology does not facilitate an efficient incorporation of all of the

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<sup>11</sup> The immutability of a blockchain arises from its “append only” nature. This means that new information can be added, but the existing information cannot be altered.

<sup>12</sup> Marino and Juels, *Setting Standards for Altering and Undoing Smart Contracts*, Rule ML, 2016 pp. 151-166.



possible events which could occur into the fabric of the code of a smart contract. This leaves the question as to how the necessary flexibility can be achieved.

One possibility for achieving the effect of a reversal or change in terms is to create that result through the creation of a new smart contract which, when added to the existing contracts, has the effect of the desired reversal or change. An example of this would be a new transaction which exactly offsets an existing transaction, negating its effect. However, this solution is not perfect as the very reason for the reversal or change in performance could also legally prevent such new transactions from being legally effective. This could apply in the insolvency of one of the parties where the new transactions themselves could be void if they are entered into after insolvency has commenced.<sup>13</sup>

An alternative approach is for the architecture of the smart contract to include an “off ramp”, which allows the contract to be governed by the natural language terms agreed between the parties instead of the code. This would allow the code to govern the performance of the contract whilst it is still accurately reflecting the parties’ relationship and then ceases to govern performance where it does not. The flexibility can be left to the natural language terms in this circumstance. This mechanism can be useful in other circumstances too, such as where there is a breach or termination of the contract. This is considered in the next section of this paper.

#### 4. *Code-breaking*

As has been discussed, an attractive feature of smart contracts is that they can *ensure* performance through their self-executing nature. The “tamper-proof” nature of their execution means that performance can, as a practical matter, be counted on. There isn’t a need to consider what happens in the case of breach as the opportunity for it occurring is limited, assuming the proper operation of the smart contract. However, this issue is more complex when smart contracts are used for more than the simplest transactional relationships.

If a contract contains executory provisions which are to be performed at some time in the future, then it is always possible that they won’t be able to be performed. As described in the previous section of this paper, it won’t be possible to legally compel performance if one of the parties is insolvent — even if the contract is self-executing as a matter of process. Also, if there is a failure to perform some of the obligations of a contract, for whatever reason, the other party may want to terminate. This means that the provisions of a smart contract still need to deal with breach and its consequences.

It would be possible to include automated provisions to deal with some of these events. For example, if there were a failure to perform some obligation then the code could ensure that no further obligations need to be performed, make some sort of calculation as to the damage which is payable as a result and also effect that payment. However, this will not be sufficient to deal with termination rights which arise as a result of law, or termination rights which are discretionary rather than automatic. This is important because under many laws, if a party to a contract defaults then the other party is not compelled to terminate and it may choose not to do so. That choice could be made on the basis of other factors which are entirely beyond the scope of the contract itself — such as the impact on other contracts or relationships or information on the circumstances of other, unrelated entities. Attempting to comprehensively catalogue the consequence of breach in the code is either going to over-simplify the existing rights of a non-defaulting party under a contract (the divergence risk described earlier), or involve such a heavy use of code to contemplate the range of possibilities so as to make its use inefficient.

There is a further consideration related to breach. At common law, it is possible to willingly breach a contract. There are consequences which arise as a result, such as an obligation to compensate the other party, usually through the payment of damages. Nevertheless it is an option which parties to a contract have, and in certain circumstances (such as pending insolvency), it is an option which can prove to be important.

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<sup>13</sup> Where this is needed for important financial market infrastructure, such as clearing systems, it usually needs legislation for these effects to be given a “safe-harbour” from other laws.

It arises because of the reluctance which common law courts often have to granting orders for specific performance in the case of ordinary breach of contractual terms. This right to deliberately breach a contract is not consistent with the self-execution of coded terms. Such coded terms do not allow for deliberate breach because the terms are performed automatically. This represents another possible divergence between a traditional contract and coded terms of a contract.

For each of these two issues, there is a solution which would avoid the risk that the terms of the smart contract were different to those of the traditional contract on which it was based. That would be to include the flexibility to allow the terms of the contract to be governed by its natural language provisions instead of the coded provisions (the “off-ramp” described in the previous section). This would seem conceptually simple to implement in the case of breach of the contract. In the case of providing the same unilateral right to breach which exists under traditional contracts, this could be achieved by providing each party with the right to move the contract from its coded terms to its natural language terms at any time, and through this providing the ability to exercise the discretion not to perform.

## 5. *Recognizing smart contracts*

The previous sections of this paper have identified legal challenges in translating traditional contracts into smart contracts. Many of these can be addressed in the design of the smart contract architecture rather than changes in law. However, as smart contracts increase in relevance and scope, there is likely to also be a need to consider developments in law to recognize smart contracts themselves. Two examples of this include recognition as financial market infrastructure and as some sort of entity at law.

### *Smart contracts as financial market infrastructure*

Smart contracts can perform the same functions as financial market infrastructure. Indeed, some of the initial use cases, such as clearing and settlement and payments, are in the performance of those functions. Smart contracts and financial market infrastructure have a shared purpose, being to provide confidence to their users in the performance of transactions. Financial market infrastructure achieves this through the regulation and oversight of the operator and the legal protection given to its rules and regulations. Smart contracts achieve this through their self-executing nature, reinforced by their resilience when they are held on a blockchain or distributed ledger.<sup>14</sup>

This comparison of function and purpose between financial market infrastructure and distributed smart contracts can disguise a fundamental difference between them in their relationship with law. A key foundation of the transactional certainty enjoyed by users of financial market infrastructure is the legal protection which insulates those transactions from the local laws which would otherwise interfere with them. For example, local laws often protect the operation of clearing houses from the impact of the bankruptcy or insolvency of participants. Smart contracts on their own do not have equivalent protection and, as described earlier in this paper, are subject to the full application of local laws despite their self-executing nature.

Application of the legal protection given to financial market infrastructure would solve a number of the “translation” issues already described in this paper. If the terms of the coded contract were applied despite the operation of other laws, then the need to consider flexibility in smart contracts would be reduced. However, this protection is usually offered only to the most important systems in a jurisdiction, such as its payment systems, exchanges and clearing houses. These are highly regulated. Also, the availability of that protection is usually dependent on meeting the international principles applicable to financial market infrastructure.

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<sup>14</sup> The decentralization means that a smart contract which effects clearing and settlement can operate like a clearing system without a clearing house.

The international benchmark used for determining what is important to the safety of the financial market infrastructure is the *Principles of Financial Market Infrastructures*.<sup>15</sup> This forms a common language across jurisdictions to determine what is important and how it needs to be protected. These *Principles* identify legal standards as being critical to the “safety and efficiency” of the financial market infrastructure and they identify other principles which depend on legal constructs for their effectiveness.

Where this leaves smart contracts is that if they perform systemically important functions of the same nature as financial market infrastructure then they should warrant the same legal protection as is provided to that infrastructure. However, it will be important that before they do so, they meet the same regulatory requirements including the international standards for the provision of that protection. Of course, the consideration of smart contracts in this context cannot be completely separated from consideration of the blockchain or distributed ledger on which they are held. This technology must contribute to the satisfaction of these requirements.<sup>16</sup>

### *Smart contracts as legal entities*

In the sphere of technology and data science, a smart contract can be referred to as an *entity* to which payments and deliveries can be made and from which payments and deliveries can be received. This is most relevant in multi-party smart contracts such as the decentralized autonomous organization (DAO).<sup>17</sup> From the perspective of traditional contract law this would seem nonsensical as the smart contract is the relationship between legal entities and is not a legal entity itself. However, this deserves further consideration.

A multi-party smart contract, like the DAO, can operate as a business vehicle which facilitates economic co-operation between those who participate in it. Instead of articles of association and shareholders agreements, they operate according to bylaws expressed in the interlocking software code. They have no registered offices, directors or employees. Once the smart contracts are created and deployed on a blockchain or other distributed ledger technology then human involvement is limited as the operation, management and control is automated. Decisions can be made by collective votes made by persons who hold tokens, which represent investments which have been made (these investments are made by contributing digital currency “to” the smart contract).

From an historical perspective, there are a number of types of entities which are now supported by some level of recognition, but which originally were formed as agreements between persons to jointly undertake commercial enterprises. These include partnerships, companies and trusts. Legal recognition was made available to clarify their relationships with other entities, and facilitate their regulation.<sup>18</sup> If these multi-party smart contracts increase in use, then these same issues may arise. For example, it may become important for such arrangements to have in place governance arrangements which are beyond the code and regulation through legal recognition could be a means of achieving this.<sup>19</sup> Accordingly, it is not impossible that multi-party smart contracts could be recognized in the same way.

There are a number of ways in which such recognition could be provided under local law if it were decided to be beneficial. Of course, these entities are unlikely to be constrained by international borders

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<sup>15</sup> Published by CPSS-IOSCO, April 2012.

<sup>16</sup> Consideration of the manner in which blockchain and distributed ledger technology can meet the PFMI is a worthy subject of a separate paper.

<sup>17</sup> The DAO was a smart contract created on a distributed ledger platform intended to automatically facilitate the investment of digital currency into projects. Its terms were said to be limited to its code. It failed with spectacular effect when the code was found not to be consistent with many participants expectations when one participant was able to withdraw funds well in excess of those contributed by it.

<sup>18</sup> The process of recognition of company status under 19<sup>th</sup> Century English law, through unincorporated associations to deed of settlement companies, bears some interesting comparisons.

<sup>19</sup> Indeed, the absence of an external governance arrangements was a contributing factor to the difficulties experienced in connection with the DAO’s failure. There is an analogy to the need for natural language provisions in bilateral smart contract to complement the coded provisions of a smart contract.

and the issues of recognition become more complex when the conflicts of laws issues which arise with cross-border transactions are added. This is considered in the next section of this paper.

## 6. *Conflicts beyond between code and law*

This paper has described circumstances in which the interaction between smart contracts and laws which will apply to them cause a need either for care to be taken in the design of the smart contract's architecture or for consideration to be given to adjustments to local laws. However, commercial contracts often operate in a cross-border context with the result that there is a need to consider more than just one country's laws. This needs to be taken into account in smart contract architecture and expands the consideration of adjustments in law into a need to consider harmonization of those adjustments and laws.

It might initially be thought that the issues of conflict of laws arise because part of the smart contract is expressed in code. For example, one of these issues could be that the governing law of the contract could be difficult to ascertain from the code. However, this issue is likely to be able to be solved with smart contracts which have both coded and natural language provisions as the natural language provisions could record the parties' agreement as to the governing law in the same manner as is used for traditional contracts.

Far more complex conflict of law issues arise because of the combination of smart contracts with blockchain and distributed ledger technology. This is because the resulting distributed nature of the smart contract means that its coded provisions exist, and are being performed, simultaneously in multiple places, some of which could be in different legal jurisdictions. Importantly, this is not an issue which arises in other cross-border commerce. Two examples of the issues which require consideration are:

- ***The location of the smart contract itself.*** A contract's location could be relevant for different reasons, including in connection with the applicability of regulation or taxation. Also, it could be important for dealing with the proprietary aspects of contractual rights, such as transfer of those rights or granting a security interest over them. Local laws do not always provide that the location of a contract for these purposes is a matter of the parties' agreement. It can be a matter of objective determination based on the place of performance. Of course, tests have been developed in local laws to work this out for traditional contracts. However, these tests are not likely to operate effectively when applied to a smart contract which is partly held on, and effected through, a distributed ledger located in multiple places equally and simultaneously.
- ***The location of property evidenced by the contract.*** The terms of a smart contract are able to execute a transaction in, and evidence the ownership of, other property. The property could be currency, securities or other assets which are recorded on a blockchain or distributed ledger. The location of that property is likely to be relevant to the application of a number of local laws, including those related to taxation, duties and taking security. The concept of applying these laws to assets which are recorded on a register is not new and the possibility of multiple registers also exists with some current asset holding systems, such as for dematerialized and intermediated securities. However, what is different about property held in smart contracts on a distributed ledger is that there is no hierarchy between the different records. They are equal in status and synchronized. It is not the same as the holding of property in different layers of custodian and clearing system accounts where a "chain of title" can be tracked through the different registers. Accordingly, the tests used for a hierarchy of accounts are not likely to be effective when applied to multiple, unsubordinated, registers.<sup>20</sup>

This is not a comprehensive list of potential cross border issues. Others include legal issues relating to privacy, data regulation, anti-money laundering laws and licensing for regulated services. However, these alone demonstrate a need for a solution which is more than the terms of the parties' agreements. Instead, a harmonized approach is needed across jurisdictions which seeks to take advantage of the efficiency, speed and performance benefits provided to commerce by smart contracts.

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<sup>20</sup> For example, applying "PRIMA" (place of the relevant intermediary approach) in these circumstances would be challenging.

## 7. *Lost and found in translation*

This paper submits that legal challenges in translating traditional contracts into smart contracts for use in commercial transactions requires care in ensuring that nothing is lost, and that some new solutions be found.

Ensuring nothing is lost requires flexibility beyond the use of computer code. This is needed because of the inability of the logic expressible in code to describe the richness of all of a contract's provisions or the law which might be applicable to it. This does not mean that smart contracts have no application beyond the simplest of transactions. Instead it means that there needs to be significant care in the design of the smart contract's architecture to provide the flexibility required for real world operation.

The solution to be found is a contribution by law itself, particularly when it comes to cross-border application. This is because the normal principles used to determine applicability of laws do not contemplate an architecture which can operate independently of the parties and which can operate in multiple jurisdictions equally and simultaneously. This contribution is in the form of local law recognition of particular elements of smart contract architecture and cross-border harmonization of those local laws.

The depths of legal analysis needed to conduct both local law recognition and cross-border harmonization of these laws effectively may seem beyond the scope of the current proofs-of-concept and pilots which are being developed for smart contracts and the blockchain and distributed ledger technologies on which they are maintained. However, given the expanding use cases, and the time needed for that analysis to be completed and implemented, it would seem that there is little time to lose.

# *A Digital Revolution in International Trade? The International Legal Framework for Blockchain Technologies, Virtual Currencies and Smart Contracts: Challenges and Opportunities*

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## *A. Introduction and definition of the key notions*

This work investigates the legal dimension of the ongoing “blockchain revolution”<sup>1</sup>. In particular, it tries to understand to what extent this potentially breakthrough technology also implies a legal revolution: do blockchain technologies, virtual currencies and smart contracts require new legal avenues to be developed, or is it instead appropriate to simply adapt existing legal categories to the new reality? In either case, how are and should they be regulated?

A specific object of inquiry in this regard is the role of UNCITRAL and its potentially crucial contribution it can provide to the creation of a worldwide legal environment that is suitable for the development of blockchain-based applications, contracts, businesses, and so forth.

After drawing a background picture of how such innovations could revolutionize the world of international trade (B.), the article gives an overview of the state of the art of the legal context in which they have currently been framed (C.), then moving on to focus on the specific issue of how UNCITRAL could helpfully intervene in their development (D.). Finally, some conclusive remarks are offered (E.).

Before starting the actual analysis, though, I believe it is necessary to devote some space to defining the most relevant notions used in this work, i.e. virtual currencies, Blockchain and distributed ledger technology, and (decentralized) smart contracts.

## *Virtual Currencies*

Even if a universally-accepted definition is missing, the so-called virtual currencies (often also referred to as cryptocurrencies<sup>2</sup>) have recently been defined:

- by the International Monetary Fund, as “digital representations of value, issued by private developers and denominated in their own unit of account”<sup>3</sup>;
- by the European Central Bank, as “a digital representation of value, not issued by a central bank, credit institution or e-money institution, which, in some circumstances, can be used as an alternative to money”<sup>4</sup> and “a digital representation of value that is neither issued by a central bank or a public authority, nor attached to a legally established currency, which does not possess the legal status of currency or money, but is accepted by natural or legal persons, as a means of exchange and possibly also for other purposes, which can be transferred, stored or traded electronically”<sup>5</sup>;

<sup>1</sup> For a definition and explanation of the term ‘blockchain’, see slightly below in the body of the article.

<sup>2</sup> A brief note on terminology is needed: both “virtual” and “crypto” currencies are “digital currencies”; in fact, as the Financial Action Task Force (FATF) clarified: “Digital currency can mean a digital representation of either virtual currency (non-fiat) or e-money (fiat) and thus is often used interchangeably with the term ‘virtual currency’” (See FATF, *Virtual Currencies Key Definitions and Potential AML/CFT Risks*, FATF REPORT, June 2014, p. 4). The difference between the two is that (only) the latter is a virtual currency in which the relevant information is carried with encryption protection. However, the terms are often used as synonyms.

<sup>3</sup> IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 7.

<sup>4</sup> ECB, *Virtual currency schemes — a further analysis*, 2015, p. 33.

<sup>5</sup> *Opinion of the European Central Bank of 12 October 2016 on a proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC*, (CON/2016/49), p. 7.

- by other European Union institutions, as “a digital representation of value that is neither issued by a central bank or a public authority, nor necessarily attached to a fiat currency, but is accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically”<sup>6</sup>;
- by the Financial Action Task Force (FATF), as “digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency”<sup>7</sup>;
- by the Superintendent of Financial Services of the State of New York, as “any type of digital unit that is used as a medium of exchange or a form of digitally stored value. Virtual currency shall be broadly construed to include digital units of exchange that: have a centralized repository or administrator; are decentralized and have no centralized repository or administrator; or may be created or obtained by computing or manufacturing effort”<sup>8</sup>.

The most prominent example of such currencies is most certainly the Bitcoin<sup>9</sup>, that legal scholarship has started to carefully investigate<sup>10</sup>.

### *Blockchain and distributed ledger<sup>11</sup> technology*

An arguably appropriate definition, provided by the ECB, describes the blockchain as “the ledger (book of records) of all transactions, grouped in blocks, made with a (decentralised) virtual currency scheme”<sup>12</sup>.

Virtual currencies are usually (and Bitcoin is the first example) based on the distributed ledger technology (DLT)<sup>13</sup>, i.e. a technology that, through computing and cryptography, has made possible to keep and validate multiple copies of a central ledger (a sort of distributed database) across an IT network; each ledger keeps a copy of the digital database of all the transactions ever happened (a transactions record), which is formed by a lot of blocks of encrypted electronic records, linked together and disseminated through a dense IT peer-to-peer network.

Anyone can check the database, but no one is able to modify it; thus, “this technology, in principle, enables a decentralised, rapid, resilient and rather secure means of recording any sort of transaction together with the history of previous transactions in a ‘distributed ledger’”. This scheme, originated with Bitcoin<sup>14</sup>,

<sup>6</sup> *Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC — 2016/0208 (COD).*

<sup>7</sup> FATF, *Virtual Currencies Key Definitions and Potential AML/CFT Risks*, FATF REPORT, June 2014, p. 4.

<sup>8</sup> But: “Virtual currency shall not be construed to include any of the following: (1) digital units that: (i) are used solely within online gaming platforms; (ii) have no market or application outside of those gaming platforms; (iii) cannot be converted into, or redeemed for, fiat currency or virtual currency; and (iv) may or may not be redeemable for real-world goods, services, discounts, or purchases; (2) digital units that can be redeemed for goods, services, discounts, or purchases as part of a customer affinity or rewards program with the issuer and/or other designated merchants or can be redeemed for digital units in another customer affinity or rewards program, but cannot be converted into, or redeemed for, fiat currency or virtual currency; or (3) digital units used as part of prepaid cards”: 23 CRR-NY 200.2 NY-CRR, Official Compilation of Codes, Rules and Regulations of the State of New York.

<sup>9</sup> Launched in 2008 by Nakamoto: Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, (2008); for useful background materials, see also <http://www.projectbitcoin.com/> and <https://bitcoin.org/en/>.

<sup>10</sup> To be sure, literature exists mostly on smart contracts: see below, note 17.

<sup>11</sup> Another brief note on terminology is needed here: the terms blockchain (or block chain) and distributed/shared ledger are often used interchangeably.

<sup>12</sup> ECB, *Virtual currency schemes — a further analysis*, 2015, p. 33.

<sup>13</sup> BIS, *CPMI report on digital currencies*, November 2015, pp. 5 ff.; available at <http://www.bis.org/cpmi/publ/d137.pdf>; see also IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 18 ff.

<sup>14</sup> See Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008).

commonly known as “blockchain technology”, is often based on open source software, publicly available. To sum up, “a block chain is a type of database that takes a number of records and puts them in a block (rather like collating them on to a single sheet of paper). Each block is then ‘chained’ to the next block, using a cryptographic signature. This allows block chains to be used like a ledger, which can be shared and corroborated by anyone with the appropriate permissions”<sup>15</sup>.

The importance of blockchain technologies has been underlined also by the IMF, that recognizing the possible benefits of virtual currencies (i.e. increasing speed and efficiency in making payments and transfers), stated: “the distributed ledger technology underlying some VC schemes offers benefits that go well beyond VCs themselves”<sup>16</sup>.

#### *(Decentralized) smart contracts*<sup>17</sup>

Already more than 20 years ago, Szabo defined smart contracts as “a computerized protocol that executes the terms of a contract”<sup>18</sup>; in other words, a smart contract is a contract written in computer language which is automatically executed by a machine.

Therefore, by applying the blockchain technology to smart contracts, they would be not only self-executing and self-enforcing, without any need for intermediaries but, in addition, every transaction would be automatically recorded in the distributed database. Thus, blockchain-based smart contracts<sup>19</sup> may be referred to as “decentralized smart contracts”, given the absence of a central database/register.

#### *B. International Trade: Virtual Currencies, Smart Contracts and Blockchain*

International trade might be severely affected by such new technologies for a number of reasons: firstly, a lot of companies are starting to accept payments in Bitcoin (and other virtual currencies) all over the world<sup>20</sup>; secondly, blockchain technologies may allow significant cost savings<sup>21</sup>, and potential

<sup>15</sup> *Distributed Ledger Technology: beyond block chain*, a report by the UK Government Chief Scientific Adviser, 2016, p. 17.

<sup>16</sup> *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 35.

<sup>17</sup> See Perugini, M. L. & Dal Checco, P., *Smart Contracts: A Preliminary Evaluation*, December 2015. Available at: <https://ssrn.com/abstract=2729548>; Raskin, Max, *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming. Available at: <https://ssrn.com/abstract=2842258>; Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016. Available at SSRN: <https://ssrn.com/abstract=2885241>.

<sup>18</sup> Szabo, N., *Smart Contracts*, 1994, unpublished (the original document is unavailable on the Author’s website, but the definition was referred to in other later publications); Szabo, N., *Formalizing and Securing Relationships on Public Networks*, First Monday, [S.I.], 1997. Available at: <http://ojphi.org/ojs/index.php/fm/article/view/548/469>; Szabo, N., *The Idea of Smart Contracts*, 1997; available at: <http://szabo.best.vwh.net/idea.html>; Szabo, N., *Secure Property Titles with Owner Authority*, 1998; see also Mark S. Miller, *Computer Security as the Future of Law*, 1997. Available at <http://www.caplet.com/security/futurelaw/>.

<sup>19</sup> It is worth pointing out that the notion of ‘smart contracts’ could encompass any automatically-executed machine-based agreement (such as purchasing a snack from a vending machine), whereas blockchain-based smart contracts are a much narrower notion (some analogies between the two might still be usefully applied, as will be pointed out in Part D.).

<sup>20</sup> E.g. EY Switzerland: [http://www.ey.com/Publication/vwLUAssets/ey-news-release-switzerland-accepts-bitcoins-for-payment-of-its-services/\\$FILE/ey-news-release-switzerland-accepts-bitcoins-for-payment-of-its-services.pdf](http://www.ey.com/Publication/vwLUAssets/ey-news-release-switzerland-accepts-bitcoins-for-payment-of-its-services/$FILE/ey-news-release-switzerland-accepts-bitcoins-for-payment-of-its-services.pdf).

<sup>21</sup> Investigating the possible advantages of the technology goes far beyond the purposes of this paper; I will just observe that businesses may consider adopting this technology for many different reasons (e.g. immutability, digitization, automation, paperless processes, rapidity, absence of middle-man, etc.).



applications to everyday business are on their way<sup>22</sup>; lastly, what if instead of paper contracts, some businesses started to use smart contracts<sup>23</sup>?

Moreover, what appears to be more appealing is that smart contracts are automatically enforced without any need for a third party<sup>24</sup>; the reduction of transaction and litigation costs for undertakings may be massive.

In other words, while traditional currencies require a central system of administration/central registry, virtual currencies do not, being decentralized by nature and self-executed by a software<sup>25</sup>. The same may be said with regard to smart contracts: if they are self-executed, there is no need for a central third party (*i.e.* judges, arbitrators) to administer them: there is (at least in theory<sup>26</sup>) no way of breaching them<sup>27</sup>.

We can imagine a scenario in which two enterprises, through a (decentralized) smart contract, define and regulate their business relations and payment obligations so that they are automatically executed via Bitcoin. Platforms to draft and use smart contracts in everyday life already exist; the best-known example is Ethereum, “a decentralized platform that runs smart contracts: applications that run exactly as programmed without any possibility of downtime, censorship, fraud or third party interference. These apps run on a custom built blockchain, an enormously powerful shared global infrastructure that can move value around and represent the ownership of property. This enables developers to create markets, store registries of debts or promises, move funds in accordance with instructions given long in the past (like a will or a futures contract) and many other things that have not been invented yet, all without a middle man or counterparty risk”<sup>28</sup>.

Going back to the opening point of this paragraph, it seems rather likely that international trade will be affected by virtual currencies, blockchain technologies and smart contracts. In any case, what is needed

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<sup>22</sup> See *e.g.* the R3 project: “R3 is a financial innovation firm that leads a consortium partnership with over 50 of the world’s leading financial institutions. We work together to design and deliver advanced distributed ledger technologies to the global financial markets” (<http://www.r3cev.com/about/>). In addition, as mentioned below in the article, the first blockchain-related patents are being filed.

<sup>23</sup> The advantages and disadvantages of using smart contracts instead of a traditional paper contract should be evaluated on a case by case analysis, keeping in mind the objectives of each single agreement and the peculiarity of the situation. In any case, it has been observed that “it is quite possible to expect that at some moment of time Smart contracts will become routine technology, like Internet itself in 90s years of the last century” (Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 20).

<sup>24</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 18: “There is no need to seek for enforcement of Smart contract by addressing the claims to third party — judiciary or other enforcement agency. And it is one of the main “selling points” of this contractual form”.

<sup>25</sup> IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 6.

<sup>26</sup> But, in practice, huge scandals have already made the headlines, such as the “DAO case”, speaking of which it has been said that “to date, the largest application of this kind of thinking has been the creation of a decentralized autonomous organization or DAO in 2016. The idea was to create an investing entity that would not be controlled by any one individual, but by shareholders voting based on their stakes on a blockchain. The entity was funded with \$150 million. Soon after this money was raised, about \$40 million of those funds were diverted from the organization, using part of the code that no one had anticipated” (Raskin, M., *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming. Available at: <https://ssrn.com/abstract=2842258>, p. 36) and that “recent example with the hack attack on Ethereum DAO in June 2016 shows that certain mechanism of reaching a consensus between the parties to Smart contract on certain unexpected (non-programed) events is necessary” (Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 22-23).

<sup>27</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 18: “Smart contract cannot be breached by a party to it”.

<sup>28</sup> <https://www.ethereum.org/>.

is at least a study-and-watch approach<sup>29</sup> to be ready when and if such innovations will come into the game of international trade. A similar position has been expressed, among the others<sup>30</sup>, by the Bank for International Settlements, which recognized that “digital currencies and distributed ledgers are an innovation that could have a range of impacts on many areas, especially on payment systems and services. These impacts could include the disruption of existing business models and systems, as well as the emergence of new financial, economic and social interactions and linkages”<sup>31</sup> and concluded by saying that “central banks could consider — as a potential policy response to these developments — investigating the potential uses of distributed ledgers in payment systems or other types of FMIs”<sup>32</sup>. The same applies to authorities, institutions, and more generally to States’ Legislatures. The IMF for instance has even proposed some principles which could guide national authorities in further developing their regulatory responses to virtual currencies<sup>33</sup>.

What is missing, however, are some recommendations on how to take advantages of blockchain in doing business, especially how to accept payment in virtual currencies minimizing legal risks and how to write and use a legally binding smart contracts and what consequences arise from it.

With specific regard to international trade, moreover, it has recently been launched an interesting project called “Incochain”, that is to say, incoterms translated into decentralized smart contracts. According to the description of the project, “Incochain is a project that is creating smart contracts for world trade. The combination of existing incoterms, or standardized international commercial terms, smart contracts and blockchain technology is where we are taking the industry — to completely paperless and mobile applications. Be it import or export, air, ocean, rail, or trucking, there is a lot of paperwork. This project clearly defines the obligations and risks of buyers and sellers and offers a dashboard system in a decentralized manner yet it can be utilized cross sector, be it international and maritime law, cargo insurance, banking and accounting, customs and government (including duties and taxes), warehousing, and transportation sectors”<sup>34</sup>.

Virtual currencies, blockchain technologies and smart contracts are already being experienced in international trade, even if in their embryonic form. But what about the legal issues they raise?

### C. The Current Legal Framework

To be sure, an international legal framework tailored on virtual currencies and blockchain technologies and applications does not exist<sup>35</sup>; however, at national/regional level, some legal systems (e.g. the State of New York in the US<sup>36</sup>) have adopted a regulation on the subject matter, while others (e.g. the EU<sup>37</sup>) are

<sup>29</sup> The same approach has been adopted by the ECB; see *Virtual currency schemes — a further analysis*, ECB, 2015, p. 33.

<sup>30</sup> See e.g. the *Special Address of CFTC Commissioner J. Christopher Giancarlo Before the Depository Trust & Clearing Corporation 2016 Blockchain Symposium* in which it was highlighted “The Need for a “Do No Harm” Regulatory Approach to Distributed Ledger Technology”.

<sup>31</sup> BIS, *CPMI report on digital currencies*, November 2015, available at <http://www.bis.org/cpmi/publ/d137.pdf> p. 17.

<sup>32</sup> BIS, *CPMI report on digital currencies*, November 2015, available at <http://www.bis.org/cpmi/publ/d137.pdf> p. 18.

<sup>33</sup> IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 35 ff.

<sup>34</sup> <https://hack.ether.camp/public/incochain>.

<sup>35</sup> For an exhaustive picture of the current legal framework all over the world, see Tasca, P., *Digital Currencies: Principles, Trends, Opportunities, and Risks*, Deutsche Bundesbank and ECUREX Research, ECUREX Research Working Paper, 7th of September 2015 (version: October 2015), pp. 43 ff.

<sup>36</sup> I refer to the Virtual Currencies regulation: *Official Compilation of Codes, Rules and Regulations of the State of New York, Title 23. Financial Services, chapter 1. Regulations of the Superintendent of Financial Services, Part 200. Virtual Currencies*. Available at: [https://govt.westlaw.com/nycrr/Browse/Home/NewYork/NewYorkCodesRulesandRegulations?guid=I7444ce80169611e594630000845b8d3e&originationContext=documenttoc&transitionType=Default&contextData=\(sc.Default\)](https://govt.westlaw.com/nycrr/Browse/Home/NewYork/NewYorkCodesRulesandRegulations?guid=I7444ce80169611e594630000845b8d3e&originationContext=documenttoc&transitionType=Default&contextData=(sc.Default)).

<sup>37</sup> See the *Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist*

willing to do that, but currently it is not possible to predict when, if and to what extent such regulations will ever be adopted<sup>38</sup>.

This may be due in part to the complexity of these technologies, and mostly to the more general inability of modern States' legislative process to follow the rapid evolution of technology. Moreover, some Institutions/Authorities expressed a fear to stifle innovation, and favoured an approach of precautionary monitoring, rather than pre-emptive regulation<sup>39</sup>. In any case, it shall be pointed out that a trend is emerging: in the US, digital currencies are usually classified as commodities<sup>40</sup>, while in the EU<sup>41</sup>, at least at national level, they are often classified as units of account<sup>42</sup>.

In addition, it has been observed that, even if “there is currently no EU legislation on virtual currencies”, this “does not mean they are completely unregulated in Member States. Rather, patchworks of national legislation, compatible to a varying degree, exist in some Member States, while others have no legislation at all”, and that “in many Member States, nothing more than a series of opinions and warnings has been issued by central banks or regulators”<sup>43</sup>.

With regard to the blockchain, it must be said that, being a (neutral) technology, it seems much more reasonable to wait and regulate the possible uses of it, rather than the technology itself, paying attention, once again, not to stifle innovation. As of today, it seems that no national, regional or international regulation exists. Nonetheless, the topic is clearly under consideration at the legislative/regulatory level: as it has been said, “today is all about blockchain brainstorming”<sup>44</sup>. As regards the need for a specific regulation, it has been noticed that “the growing interest in blockchain technology, independent from a VC scheme, a priori raises fewer policy concerns, because the technology would be used in a closed system administered by regulated financial institutions”<sup>45</sup>.

However, “bitcoin may have triggered something which goes well beyond virtual currencies. Although the blockchain technology was initially meant to implement Bitcoin's currency business model, it now seems to be emerging as a promising means to achieve a number of other goals. Blockchain technology could find its way into the mainstream financial markets. The technology may be used in a variety of

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*financing and amending Directive 2009/101/EC.*

<sup>38</sup> Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members' Research Service, PE 579.110, 2016, p.10: “It is too early to assess the possible impact of the forthcoming EU legislation on virtual currencies, but there is little doubt that it will be profound. Whether it will affect the growth of the emerging virtual currency industry, or provide it with a more stable regulatory framework, thus increasing its acceptance as money and eventually allowing it to become mainstream, is an open question”.

<sup>39</sup> See for example Committee on Economic and Monetary Affairs, *Report on Virtual Currencies*, (2016/2007(INI)), 3.5.2016; the IMF recommended that “regulatory responses should be commensurate to the risks without stifling innovation” (IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 35); also the New York Department of Financial Services has clarified that there is a need to “strike an appropriate balance that helps protect consumers and root out illegal activity, without stifling beneficial innovation” (<http://www.dfs.ny.gov/about/press/pr1407171.htm>); and the UK HM Treasury has stated that: “regulatory requirements must be proportionate to the risk posed, to avoid unnecessarily stifling competition and innovation in a nascent industry” ([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/414040/digital\\_currencies\\_response\\_to\\_call\\_for\\_information\\_final\\_changes.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414040/digital_currencies_response_to_call_for_information_final_changes.pdf)).

<sup>40</sup> See CFTC press release at: <http://www.cftc.gov/PressRoom/PressReleases/pr7231-15>.

<sup>41</sup> See the annex to ECB, *Virtual currency schemes — a further analysis*, 2015 pp. 34 ff.

<sup>42</sup> See Tasca, P., *Digital Currencies: Principles, Trends, Opportunities, and Risks*, Deutsche Bundesbank and ECUREX Research, ECUREX Research Working Paper, 7th of September 2015 (version: October 2015), p. 56. See the annex to ECB, *Virtual currency schemes — a further analysis*, 2015 pp. 34 ff.

<sup>43</sup> Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members' Research Service, PE 579.110, 2016, p. 7.

<sup>44</sup> *Digital Transformation in Government and Blockchain Technology*, speech delivered by Minister for Cabinet Office Matt Hancock at D Digital Catapult, Kings Cross, London on the 26<sup>th</sup> April 2016. Available at: <https://www.gov.uk/government/speeches/digital-transformation-in-government-and-blockchain-technology>.

<sup>45</sup> IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 24.

application where data have to be transmitted without risk of corruption. The handicap for Blockchain technology might be that it first appeared in the particularly sensitive and highly regulated field of currencies, having attracted the regulators' attention while still at an immature stage, and with its potential not fully understood<sup>46</sup>.

Therefore, it is indeed possible that a regulation on virtual currencies indirectly provides some rules related to the blockchain technologies, and this may well have negative effects on the blockchain<sup>47</sup>. No doubt that the technology is at the center of the stage (for instance, Bank of America recently filed 15 blockchain-related patents<sup>48</sup>) and, as a consequence, careful steps must be taken.

Speaking of smart contracts, their legal status is totally "unclear"<sup>49</sup>, and very little has been written with this regard<sup>50</sup>; I will try to address some potential issues in part D. However, the fact that there is no specific regulation on such issues does clearly not mean that current laws and general principles of law may not be applicable to them, or that they are unregulated at all: virtual currencies may well be considered as any other currency, and/or as means of exchange, while the blockchain and smart contracts are indeed pieces of software<sup>51</sup>. To be sure, in the absence of specific regulations, these technologies must be regulated by existing laws<sup>52</sup>.

For example, the ECJ made clear, applying the relevant provisions of the existing European VAT Directive, that the exchange of traditional currencies for units of the 'bitcoin' virtual currency is exempt from VAT<sup>53</sup>.

In the US, Judge Teresa Pooler wrote that "the Florida Legislature may choose to adopt statutes regulating virtual currency in the future. At this time, however, attempting to fit the sale of Bitcoin into a statutory scheme regulating money service business is like fitting a square peg in a round hole" and stated that the sale of bitcoin does not constitute a "money service business" in a case regarding unauthorized money transmission and money laundering<sup>54</sup>. However, in another case<sup>55</sup>, it was reached the (opposite) conclusion that Bitcoins qualify as money since they "are funds within the plain meaning of that term [and] can be accepted as a payment for goods and services or bought directly from an exchange with a bank account. They therefore function as pecuniary resources and are used as a medium of exchange and a means of payment"<sup>56</sup>.

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<sup>46</sup> Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members' Research Service, PE 579.110, 2016, p. 10.

<sup>47</sup> Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members' Research Service, PE 579.110, 2016, p. 10, note 7.

<sup>48</sup> Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members' Research Service, PE 579.110, 2016, p. 10, note 9.

<sup>49</sup> *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, p. 23.

<sup>50</sup> See Perugini, M. L. & Dal Checco, P., *Smart Contracts: A Preliminary Evaluation*, December 2015; Raskin, Max, *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming. Available at: <https://ssrn.com/abstract=2842258>; Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016. Available at SSRN: <https://ssrn.com/abstract=2885241>.

<sup>51</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 20: "it is possible to argue that each Smart contract by its legal nature is also a computer program in a meaning of IP law".

<sup>52</sup> See e.g. Tasca, P., *Digital Currencies: Principles, Trends, Opportunities, and Risks*, Deutsche Bundesbank and ECUREX Research, ECUREX Research Working Paper, 7th of September 2015 (version: October 2015), p. 26: "The general orientation is to adopt the current legislation already in place in order to deal with digital currencies in Europe".

<sup>53</sup> Case C-264/14.

<sup>54</sup> Case n. F14-2923, Criminal Division, section 13 of the 11th Judicial Circuit in and for Miami-Dade County, Florida. See also <http://www.coindesk.com/court-reject-bitcoin-money-florida-espinoza-trial/>.

<sup>55</sup> See *U.S. v Murgio et al*, U.S. District Court, Southern District of New York, No. 15-cr-00769.

<sup>56</sup> See <http://www.reuters.com/article/us-jpmorgan-cyber-bitcoin-idUSKCN11P2DE>.



It should be noticed, however, that most of the policymakers', central banks', authorities' (and judges') concerns<sup>57</sup> have until now regarded almost exclusively monetary policies<sup>58</sup>, financial aspects<sup>59</sup>, or issues related to public law and tax law<sup>60</sup>, with a particular focus on money laundering and financing of terroristic activities<sup>61</sup>, while a lot of practical issues concerning substantive private/trade law have been left unanalysed and unanswered, apart from some analysis on consumer protection<sup>62</sup>; I move on to consider such issues in the next paragraph.

#### D. *Legal Questions Related to the Substantive Private Law Governing International Trade. The Role of UNCITRAL*

The technologies discussed through this paper may become relevant in the future of international trade but, as already mentioned, while from a public law point of view a lot of analysis has already been carried out, it seems that, as far as commercial law is concerned, a lot of questions still need to be answered.

This paragraph will briefly outline and address some legal questions that may arise using this technology in this respect, how such questions may be resolved on the basis of the current legislation, and how they should be addressed by policy makers.

The first problem is related to the legal status of virtual currencies: in fact, as already mentioned, some legal systems have already legislated on this field, a lot of authorities have given their opinion, and the EU is evaluating if, when and how to legislate.

However, with regard to contract law, the provision to accept payments in virtual currencies may be dealt with through an *ad hoc* provision in a commercial agreement; with regard to problems arising from their legal status, in absence of a specific regulation, authorities will likely (try to) apply the current legislation.

Real troubles for businesses come with what I referred to in paragraph A. as “decentralized smart contracts”, *i.e.*, smart contracts based on blockchain technologies, which automatically execute any given contract, providing a proof of that performance in the distributed ledger.

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<sup>57</sup> For a general overview, see the chart at p. 52 in Tasca, P., *Digital Currencies: Principles, Trends, Opportunities, and Risks*, Deutsche Bundesbank and ECUREX Research, ECUREX Research Working Paper, 7th of September 2015 (version: October 2015).

<sup>58</sup> See for example BIS, *CPMI report on digital currencies*, November 2015, available at <http://www.bis.org/cpmi/publ/d137.pdf>, which concluded at p. 21 that “There could also be potential effects on monetary policy or financial stability”; Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members’ Research Service, PE 579.110, 2016, pp. 4 ff.; see also IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 33 ff.; finally, see ECB, *Virtual currency schemes — a further analysis*, ECB, 2015, p. 32.

<sup>59</sup> See for example *CPMI report on digital currencies*, BIS, November 2015, available at <http://www.bis.org/cpmi/publ/d137.pdf> in which it is concluded (p. 21) that “There could also be potential effects on monetary policy or financial stability”; Scheinert, C., *Virtual currencies, Challenges following their introduction*, EPRS | European Parliamentary Research Service, Members’ Research Service, PE 579.110, 2016, pp. 4 ff.; see also *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 31 ff.; finally see ECB, *Virtual currency schemes — a further analysis*, 2015, p. 32.

<sup>60</sup> See IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 30 ff.

<sup>61</sup> See for example the UK national risk assessment (available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/468210/UK\\_NRA\\_October\\_2015\\_final\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf)), where it has been written that “The money laundering risk associated with digital currencies is low, though if the use of digital currencies was to become more prevalent in the UK this risk could rise”, or the *Europol Report on the Changes in the Modus Operandi of Is in Terrorist Attacks* (available at: [https://www.europol.europa.eu/sites/default/files/publications/changes\\_in\\_modus\\_operandi\\_of\\_is\\_in\\_terrorist\\_attacks.pdf](https://www.europol.europa.eu/sites/default/files/publications/changes_in_modus_operandi_of_is_in_terrorist_attacks.pdf)), where they investigated the possible use of Bitcoin by terrorist to finance their activities.

<sup>62</sup> See IMF, *Virtual Currencies and Beyond: Initial Considerations*, IMF Staff Discussion Note — SDN/16/03, January 2016, pp. 28 ff.

In this regard, the first thing to notice is that, “using the blockchain functions imposes some technical limits: as a matter of facts, indirect e-commerce performances are not digitally executable. Therefore, the scheme is not covering any agreement regarding goods or services that, even though purchased on the Internet, have a material consistence or are to be performed in the real world, like a book delivery or a maintenance service”<sup>63</sup>.

This is due to the dichotomy between real and virtual world: let us imagine that, through a smart contract, A buys an object from B (who regularly pays the agreed price), but thereafter C steals the real good from A; at this point, on the blockchain there is no way to change the status of owner of A, who may well sell his virtual “title” to D, who will never physically possess the good which has bought but, at the same time, will never be able to stop the payment automatically executed by the smart contract. This is why it seems possible to argue that smart contracts may function only with digital goods and digital inputs<sup>64</sup>. Nonetheless, even if such limitation had to be applied, smart contracts would still be applicable to a lot of goods of the modern era. But what is the legal nature of smart contracts?

On the one hand, some have recently argued that a “smart contract can be regarded as a legally-binding agreement”<sup>65</sup>; on the other, it has been said that “smart contracts are simply a new form of preemptive self-help”<sup>66</sup>.

With regard to the idea that smart contracts are themselves autonomous and self-sufficient legally-binding agreements, it shall be noticed that in fact they will almost always represent the translation of part of an already reached agreement into digital code: this is because they simply perform automatically the contract but they can enforce only provisions that may be executed in the digital world. In this regard, it has been said that using smart contracts “there is no need in conflict of laws provisions, since there are no collisions of various legal systems. Mathematics is universal human language. Thus, Smart contracts are truly transnational and executed uniformly regardless of the differences in national laws”<sup>67</sup>, and even that smart contracts do not create a proper obligation in its legal meaning<sup>68</sup>.

Such conclusion, though, seems difficult for me to be agreed upon. Firstly, even considering smart contracts as legally-binding agreements, they would *a fortiori* be subject to contract law, and it is clear that the applicable law will have a strong influence on them; for example, with regard to illegality and unconscionability, every country has its own peculiar rules, and a contract may well be valid in one place and null and void in another one.

Moreover, smart contracts do clearly create obligations which stand independently from the digital code of the smart contracts: if for example there is a bug in a smart contract between A and B, and A has undertaken to transfer her property in exchange for an agreed sum of money to B, she would still be obliged to transfer her property to B even if the smart contract does not work (similarly, if a vending machine does not deliver the chosen good after the insertion of the coin, it is clear that the owner of the selling machine is still obliged to perform and deliver the good).

In any case, by entering into a smart contract, parties undertake to perform the obligation therein encapsulated; in addition, since — as was said — almost always smart contracts will be a translation of a precedent agreement already reached, the obligations of parties would nonetheless be, at the very least, to start the execution of the smart contract (*i.e.* to press the button that starts to operate the smart contract).

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<sup>63</sup> Perugini, M. L. & Dal Checco, P., *Smart Contracts: A Preliminary Evaluation*, December 2015, p. 10.

<sup>64</sup> Perugini, M. L. & Dal Checco, P., *Smart Contracts: A Preliminary Evaluation*, December 2015, pp. 10 ff.

<sup>65</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 10 and ff.

<sup>66</sup> Raskin, M., *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming, abstract. Available at: <https://ssrn.com/abstract=2842258>.

<sup>67</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, p. 21.

<sup>68</sup> Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, pp. 17 ff.

Generally speaking, in spite of the conceptual dissimilarities, there actually do not appear to exist too many differences between the functioning of a smart contract and that of a mechanical vending machine, or that of a software that suspends the supply of a service in case of missing payment (e.g. Netflix allows users to legally watch streaming videos in exchange for a monthly payment; in case of missing payments, the software will simply suspend the service, not allowing users to log in<sup>69</sup>): the fact that the interruption is performed by humans, by software, or by smart contracts with a record in the blockchain, does not in practice seem make a relevant difference legally-wise.

I therefore agree with the scholars who concluded that, “independently from being digitally expressed, every contract is ruled and guaranteed by the law and the parties will be free to file the Court for compensation in case a void agreement has been performed or execution has been spoiled by a malfunctioning due to a system bug”<sup>70</sup>.

Another interesting point that was made by the scholarship is the idea that smart contracts are simply a new form of self-help measures, which parties to a contract adopt in order to ensure the performance of their agreements without the need of judicial enforcement<sup>71</sup>. This is consistent with the above-mentioned observation that what usually happens, at least at the moment, is that two parties reach an agreement and thereafter translate part of it into a smart contracts, and then leave the duty to perform it to the machine. In this case, all the relevant legal questions arising from smart contracts must be dealt by the competent judge under the applicable contract law.

In any case, independently of the legal nature of such contracts, another issue to be faced is the probative value of blockchain technology; also, and connected to this, one might wonder: “what happens when the outcomes of the smart contract diverge from the outcomes that the law demands”<sup>72</sup>? Once again, the answer depends on the applicable law.

Of course, a national agreement, concluded by national businesses and to be performed only on the national soil, would clearly be subject to the corresponding national law, and the jurisdiction would be determined according to the procedural law of that country.

But in relation to international trade, everything is different: it is self-evident that smart contracts may generate enormous problems if the applicable law and the competent jurisdiction are not clearly determined in the agreement; however, as observed above, smart contracts, by their very nature, cannot contain provisions not executable by software (such as the one regarding the applicable law), nor are they built with the intention to depend on a third-party judicial enforcement, and, therefore, it is still hard to imagine how they could include provisions on jurisdiction and applicable law<sup>73</sup>.

It would therefore appear to be necessary, if such contracts have to be adopted in day-to-day trade practice, a general agreement (or at least an *ad hoc* provision) that establishes, among the other things, that, in case of need of judicial enforcement, related to the general agreement itself, or to the smart contracts depending upon it, what is the applicable law and which judge has the jurisdiction.

In relation to international trade, this problem may otherwise be without solution; trying to establish the applicable law of a smart contract, in the absence of an explicit choice by the parties, would trigger the well-known problems amplified by the advent of the Internet: should we apply the *lex loci delicti*? The *lex*

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<sup>69</sup> <https://help.netflix.com/legal/termsofuse?locale=en&country=IT>: “If a payment is not successfully settled, due to expiration, insufficient funds, or otherwise, and you do not change your Payment Method or cancel your account, we may suspend your access to the service until we have obtained a valid Payment Method”.

<sup>70</sup> Perugini, M. L. & Dal Checco, P., *Smart Contracts: A Preliminary Evaluation*, December 2015, p. 25.

<sup>71</sup> Raskin, M., *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming, pp. 32 ff.

<sup>72</sup> Raskin, M., *The Law of Smart Contracts*, (September 22, 2016), Georgetown Technology Review, Forthcoming, pp. 25 ff.

<sup>73</sup> See Savelyev, A., *Contract Law 2.0: «Smart» Contracts As the Beginning of the End of Classic Contract Law*, Higher School of Economics Research Paper No. WP BRP 71/LAW/2016, 2016, pp. 20 ff.

*loci contractus*? The *lex loci rei sitae* (the place where the server on which the digital property virtually exists?); The *lex loci protectionis*? Or should we use other criteria?

Similar problems would arise with regard to jurisdiction.

Therefore, there appears to be a great need of a solution to these uncertainties, or at least a model provision/law that deals with them, in order to avoid that, in a near future, if such contracts happen to start truly spreading, businesses start to use smart contracts giving them too much confidence and, in case of failure of the software, no one knows where to file a lawsuit, according to which law, and therefore how to predict its possible outcome.

Excessive faith in technology without adequate knowledge of the inevitably arising legal problems may cause a disaster, especially in international trade. It appears to be crucial to adopt an international approach to solve these issues; otherwise, each country may provide for different regulation on the subject matter, thus introducing indirect obstacles to international trade. It appears to be better to propose a framework in advance, than to wait for a number of national laws that eventually will need to be harmonized and unified, because of the inevitable disparities. Given the rapid evolution of the technologies under consideration, it is inevitable that further studies and analyses must be carried out; nonetheless it is desirable that UNCITRAL, with its expertise in the field, leads this process.

This could be achieved through a proposed model law/rules which may be acceptable worldwide, or offering a legal guide or practical recommendations, in any case providing the technical assistance required for a similar endeavour. If this happened, many of the above-indicated questions would automatically and systematically find a solution, thus allowing for a proper exploitation of the potential of this innovation in international trade.

#### *E. Conclusions*

This paper has tried to outline the legal landscape arising from blockchain technologies and their applications, such as decentralized smart contracts and virtual currencies; it has tried to investigate if and to what extent such technologies may imply a legal revolution, or if it is sufficient to simply adapt the existing legal categories to them.

While I recognized that decentralized smart contracts, blockchain and virtual currencies may become mainstream technologies, I believe that they are not going to cause a legal revolution.

Even recognizing that a lot of regulatory issues arise from a public law perspective, this paper also focused on the less analysed issues related to international trade law. In this regard, the implementation of blockchain-based smart contracts creates problematic legal questions, particularly in relation to the applicable law and to jurisdiction. In fact, decentralized smart contracts are indeed designed with the purpose of avoiding the need of an intermediary to assure the exact performance of a contract, and to be self-sufficient and autonomous; however, sometimes, either for a bug, or for other reasons related to the dichotomy between real and virtual world, the intervention of a third party may be necessary to correct them, and to reach the required lawful outcomes of the given contract.

Nonetheless, considering that smart contracts can arguably be deemed actual contracts in their legal meaning, or at the least some form of self-help technology chosen by parties to ensure compliance with contractual obligations, it seems that most of the legal questions arising with smart contracts can and should be dealt with current contract law provisions; however, it is necessary to identify which national contract law applies to decentralized smart contracts, and this may be resolved through an *ad hoc* provision in the agreement or through the proposition of legal rules applicable to the most problematic aspects of smart contracts, *i.e.* applicable law and jurisdiction. Under this perspective, a contribution by UNCITRAL in devising model provision/agreements dealing with and regulating smart contracts would seem to be able to bring a really valuable contribution to the healthy development of these new contractual practices, and thus indirectly favour the continuing growth of international trade, keeping pace with technological innovations.



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# *Cross-Border Smart Contracts: Boosting International Digital Trade through Trust and Adequate Remedies*

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## *Introduction*

Cross-border digital contracting in recent years has witnessed the development of smart contracts that can be used for a variety of automated electronic transactions.<sup>1</sup> A number of internet platforms such as *Ethereum* have emerged that offer to create smart contracts and expand their application to these different transactions.<sup>2</sup> This expansion is bound to have an impact over the manner in which trade is currently conducted which raises the importance of regulating these new digital contracts.

As these contracts are based on programmable software their lack of flexibility as opposed to natural language contracts could lead to not fulfilling the parties' expectations, thereby leading to a potential breach of contract. This paper briefly assesses the role that the UN Convention on the Use of Electronic Communications in International Contracts and the UNCITRAL Technical Notes on Online Dispute Resolution can have in such a situation. The paper then emphasises the current gaps in the international legal framework with regards to smart contracts and their breach that requires for further research and legal regulation.

## *What are Smart Contracts?*

Smart contracts were first referred to by Nick Szabo in the 1990s as "a set of promises, specified in digital form, including protocols within which the parties perform on these promises."<sup>3</sup> On this basis it can be said that smart contracts are software codes that embed the terms and conditions of a contract and that run on a network leading to a partial or full automated self-execution and self-enforcement of the contract.

The automated performance of the contract is enabled as a result of the transfer of contractual terms and conditions into an algorithm or technology-enabled rules-based operations that signal for actions, such as payment, to be taken once the relevant conditions have been fulfilled.<sup>4</sup> In this light, it has been suggested in a recent report by the Smart Contracts Alliance that smart contracts can be used for complex transactions to enable for a simpler performance of these and to help with cutting down on costs.<sup>5</sup> Examples of such uses include using contracts for better visibility in supply chains, for mortgages or for trade finance.

## *Execution Issues and Remedies in Smart Contracts: Current Applicable UNCITRAL Texts*

Smart contracts have been designed to ensure that the contract would be performed adequately without any risk for breach. However, the code embedding the contract terms can contain bugs or produce results that are not in accordance with the expectations of the parties.<sup>6</sup> Therefore, this would mean that the smart contract can be potentially breached in such cases as its performance would not be as expected or intended by the parties. The question that ensues is whether there are current rules or guidance under the UNCITRAL texts for establishing liability and providing adequate remedies for breach in such circumstances.

<sup>1</sup> Such transactions include the facilitation of automatically executed derivatives for example. See Hedgy <https://angel.co/hedgy> (last accessed January 2017).

<sup>2</sup> See Ethereum <https://www.ethereum.org/> (last accessed January 2017).

<sup>3</sup> N Szabo, *Smart Contracts: Building Blocks for Digital Markets*, 1996.

<sup>4</sup> Smart Contracts Alliance in collaboration with Deloitte Report, *Smart Contracts: 12 Use Cases for Business & Beyond: A Technology, Legal & Regulatory Introduction-Foreword by Nick Szabo*, December 2016 <http://digitalchamber.org/assets/Smart-contracts-12-use-cases-for-business-and-beyond.pdf> (last accessed January 2017). See also, P De Filippi and S Hassan, 'Blockchain Technology as a Regulatory Technology: From Code is Law to Law to Law is Code,' *First Monday*, Volume 21, Number 12, 5 December 2016 Section IIA.

<sup>5</sup> See Smart Contracts Alliance in collaboration with Deloitte Report, *supra* n 4.

<sup>6</sup> Smart Contracts Alliance in collaboration with Deloitte Report, *supra* n 4, p. 10.

The UN Convention on the Use of Electronic Communications applies to the use of electronic communications used in the formation or performance of a contract between parties whose places of business are in different places.<sup>7</sup> According to this Convention, a smart contract<sup>8</sup> would be considered to be legally valid as these form electronically through computer code. Moreover, Article 12 disposes that contracts formed as a result of automated messages are legally valid and enforceable under the Convention. Nevertheless, there is no legal provision that offers further indication on liability in an automated contract and from whom remedies would have to be given.

Self-enforcement functions as conflict prevention in smart contracts<sup>9</sup> but issues of enforceability in the context of cross-border smart contracts due to jurisdictional variations can still arise.<sup>10</sup> In order to further solve this dilemma, smart contracts can incorporate an online dispute resolution clause in their code.<sup>11</sup> Also, an ODR clause would be useful to avoid any 'wrongful' irreversible performance of the contract without having recourse to an external source. The UNCITRAL Technical Notes on ODR offer guidance on what an ODR procedure would include and would also be compatible to be applied to an ODR provision in smart contracts. Once the ODR process gives a result, it can issue an adequate remedy for the condition or problem.

#### *Current Gaps in the International Legal Framework:*

The breach in performance by software driven automated contracts, such as smart contracts, raises important liability questions that currently do not have a direct answer in the available international legal texts. This also has implications over the remedies that the aggrieved party would be entitled to in such a context. As opposed to natural language contracts where it is clear that if the seller for example makes a late delivery due to his own wrongdoing the buyer would be entitled for relevant remedies from the seller. Errors committed as a result of codes make it more difficult to establish which party caused the breach or is liable because of it.

#### *Conclusion*

The UNCITRAL texts are equipped in dealing with smart contracts to a certain extent as they recognize automated electronic contracts and offer enforcement solutions to these through ODR. It is however the case that there is a current regulatory gap with regards to establishing liability in cases of breach of smart contracts which raises a need for an international text on these. Consequently, such a text would contribute to the removal of any current obstacles in trading via smart contracts by reinforcing the users' trust in their use which would boost international digital trade.

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<sup>7</sup> Article 1 of the Convention.

<sup>8</sup> Apart from smart contracts touching on the exceptions in Article 2.

<sup>9</sup> R Koulou, 'Blockchains and Online Dispute Resolution: Smart Contracts as an Alternative to Enforcement,' SCRIPTed, Volume 13, Issue 1, May 2016, p. 65.

<sup>10</sup> See R3 and Norton Rose Fulbright White Paper, Can Smart Contracts be Legally Binding Contracts: Key Findings,' p. 5 <http://www.nortonrosefulbright.com/files/norton-rose-fulbright--r3-smart-contracts-white-paper-key-findings-nov-2016-144554.pdf> (Last accessed January 2017).

<sup>11</sup> Ibid.

*Information Management in International Trade:  
Role of UNCITRAL in Advancing International Single Window Environment*

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## *1. Introduction*

The various international and regional institutions that have been engaged in the work on issues related to trade in digital economy has to a certain extent directed their efforts following the mantra of “trade facilitation”. Some of those efforts have supported the implementation of national and regional single windows across jurisdictions to fulfil import, export, and transit-related regulatory requirements. Interoperability and internationalization of national single windows is the next logical step, as it will allow collaborative information sharing for both public and private sector stakeholders in global supply chains.

The purpose of this paper is to present the concept of international single window environment (ISWE) as an information channel and review the legal framework necessary for implementing it. ISWE is proposed as an information channel characterised by interoperability between various national single windows. The proposed ISWE will serve as information interchange channel which has the potential of enhancing the visibility of the entire supply chain.

With the entry into force of the WTO’s Trade Facilitation Agreement (TFA),<sup>1</sup> several WTO Member States are likely to move to the broader use of electronic transactions through use of information and communications technologies (ICT) to meet their multilateral treaty obligations. For example, the TFA suggests that member-states should implement national single window (NSW) and recommend the use of ICT methods for trade. The paper considers the contribution of the TFA and suggests that once majority of the WTO Member States establish single windows, most of the necessary infrastructure for creating ISWE would be present. The paper examines past and on-going efforts of some of the relevant international and regional institutions<sup>2</sup> are examined in contextual detail to provide a legal basis for interoperability of National Single Windows through ISWE. In this context the contribution of UNCITRAL to develop the supplementary legal framework for ISWE is elaborated.

ASEAN Single Window is utilised as an example of regional single window interoperability to identify the prospects and challenges of interoperability.<sup>3</sup> Since 2005, the Association of Southeast Asian Nations (ASEAN) has been working to develop both the technical and legal frameworks for a regional Single Window referred to as the ASEAN Single Window (ASW). During the past several months ASW has supported electronic exchange of customs declaration and certificate of origin between five Member States on a pilot basis. Building upon the interim findings from the ASW experience the paper emphasises that full potential of ISWE can be realised through integration of Government-to-Government (G2G), Business-to-Government (B2G) and Business-to-Business (B2B) information. Such integration of information into an interoperable environment will allow flow of real-time data that can offer numerous possibilities to enhance the visibility of international supply chains. It is argued that single window integration at international level should include transport and related commercial requirements in order to improve information flows among all supply chain actors.

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<sup>1</sup> WTO. Trade Facilitation Agreement (WT/MIN(13)/36 or WT/L/911) [https://www.wto.org/english/thewto\\_e/minist\\_e/mc9\\_e/desci36\\_e.htm](https://www.wto.org/english/thewto_e/minist_e/mc9_e/desci36_e.htm) on 22 February 2017, the organization obtained the required acceptance from two-thirds of its 164 members for the TFA to take effect. [https://www.wto.org/english/news\\_e/news17\\_e/fac\\_27feb17\\_e.htm](https://www.wto.org/english/news_e/news17_e/fac_27feb17_e.htm).

<sup>2</sup> The efforts of institutions considered are the United Nations Economic Commission for Europe (UNECE), United Nations Economic and Social Commission for Asia and the Pacific (UN/ESCAP), United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT), United Nations Network of Experts for Paperless Trade and Transport Facilitation in Asia and the Pacific (UNNExT), World Customs Organization (WCO), World Trade Organization (WTO) and United Nations Commission on International Trade Law (UNCITRAL).

<sup>3</sup> It is to be noted that the ASW is conducting live operations on a pilot basis. Therefore, the interpretation of the empirical findings should not be related to the fully operating single window. The period analysed in this study is significantly short. Therefore, this effect should be interpreted as short-run effect of ASW on exports.

However, the integration of transport and commercial requirements in the scope of ISWE is where the challenge lies. The inclusion of the transport stakeholders into the single window system requires complex coordination that can capture the existing relationships between carrier interests, shipper interests, ports, transport authorities, insurance providers, etc., from legal and technical perspectives. Emergence of new technology has opened up possibilities for creating technical solutions for such complex arrangements. The issue of dematerialization of transport and commercial documents is another challenge. In this respect, the contribution of UNCITRAL on the issue of dematerialisation of bill of lading is profound. However, what remains unanswered is the supporting framework that would support the channelizing of dematerialised information through ISWE which is an information exchange channel. The ISWE needs to be supported by a legal framework for trusted transboundary transaction. In this context UNCITRAL could make a significant contribution through its work on trust and identity management.

## 2. Trade Facilitation

Over the last several years, numerous multilateral and regional institutions have been engaged in law-making initiatives related to e-commerce, paperless trade, electronic single window and cross-border e-transaction. Most of these initiatives feature under the broad heading of trade facilitation. Trade facilitation initiatives are commonly considered to create standards and guidelines for the exchange of goods and services across borders.<sup>4</sup> Commercial aspects of trade have also been considered within the ambit of trade facilitation by certain institutions.

WTO defines trade facilitation as:

the simplification and harmonization of international trade procedures, where trade procedures are the activities, practices and formalities involved in collecting, presenting, communicating and processing data and other information required for the movement of goods in international trade.<sup>5</sup>

UN/CEFACT defines trade facilitation as:

the simplification, standardization, and harmonization of procedures and associated information flows required to move goods from seller to buyer and to make payments.<sup>6</sup>

OECD defines trade facilitation as:

the simplification and standardization of procedures and associated information flows required to move goods internationally from seller to buyer and to pass payments in the other direction.<sup>7</sup>

The above-mentioned definitions are particularly interesting because they emphasise on the flow of information connected with the physical movement of goods.<sup>8</sup> This flow of information, which can be enhanced through digitalization of trade processes, help businesses and governmental agencies to manage

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<sup>4</sup> See the definitions of trade facilitation as used by institutions such as WTO, UN/CEFACT and WCO.

<sup>5</sup> WTO, *A Training Package: What is Trade Facilitation?* [www.gfptt.org/sites/default/files/refread/Training-guide-final.pdf](http://www.gfptt.org/sites/default/files/refread/Training-guide-final.pdf).

<sup>6</sup> UNECE, *Trade Facilitation Implementation Guide*. <http://tfig.unece.org/details.html>.

<sup>7</sup> OECD. 2005. *The Costs and benefits of Trade Facilitation*. <http://www.oecd.org/trade/facilitation/35459690.pdf>.

<sup>8</sup> A typical international supply chain features the physical movement of goods, the financial aspects of the transaction, and the flow of information within the various actors in the supply chain. The three layers exist as parallel processes with limited interaction between them. However, the use of ICT may enhance interaction between the three layers. Basu Bal, A., Rajput, T. 2015. *Creating Sustainable Global Supply Chains Through Single Window and Paperless Trade Initiatives: Efforts of WTO and UNCITRAL in Perspective* presented at UNCITRAL Emergence Conference, Macau, 30 November.



risks and reduce transaction costs.<sup>9</sup> An important practical tool for coordinating trade processes<sup>10</sup> and procedures at the border to ensure smooth flow of information is an electronic single window facility.

Single window is defined by the WCO as:

An intelligent facility that allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfil all import, export and transit related regulatory requirements.<sup>11</sup>

The benefits of single window system are well established.<sup>12</sup> *Doing Business* data reveals that less time was spent on customs clearance in countries that utilise electronic systems for the submission and processing export and import customs declarations.<sup>13</sup> Many of the upper middle-income countries use single windows and in several other countries the implementation process is underway. Some examples of national single window systems are International Trade Data System (ITDS) of US, UNI-PASS Korean Customs system and KTNET u TradeHub national trade single window of Korea, TradeXchange of Singapore and PortNet of Finland. ISWE is proposed as an information interchange channel characterised by interoperability between the various national single windows.

### 3. *TFA Can Contribute Towards Creating ISWE*

One interesting aspect that emerges from evaluating the single window reform across countries is that implementation is fragmented than desired.<sup>14</sup> Such fragmentation created the need for a comprehensive trade facilitation reform which would consolidate and multilateralize the commitments of States to create efficient trading processes and procedures at the borders.<sup>15</sup> The TFA,<sup>16</sup> which is the result of the Bali Ministerial Conference in December 2013,<sup>17</sup> is a step in that direction. Article 10 of the TFA mandates that all Members of the WTO shall endeavour to establish and maintain a single window enabling traders to submit documentation for export, import and transit of goods through a single entry point. It is important to mention that the implementation of a single window system develops on the GATT 1994 Article VIII

<sup>9</sup> There exists a positive correlation between digitalization and economic growth For more discussion on the issue *Doing Business-Trading Across Barriers: Technology Gains in Trade Facilitation*. <http://www.doingbusiness.org/reports/case-studies/2016/tab>.

<sup>10</sup> The concept of Single window is supported by several of the border management models. Aniszewski, S. 2009. *Co-ordinated Border Management — A Concept Paper*. WCO Research Paper N° 2. Also see Doyle, T. 2011. Collaborative Border Management. *World Custom Journal* 4(1): 15-21. G. Mc Linden, E. Fanta, Widdowson, D., and Doyle, T. 2011. *Border Management Modernization Handbook* <http://issuu.com/world.bank.publications/docs/9780821385968>. Arvis, J-F., Mustra, M. A., Ojala L., Shepherd, B., Saslavsky, D. 2010. *Connecting to Compete: Trade Logistics in the Global Economy* <http://siteresources.worldbank.org/INTLAC/Resources/ConnectingtoCompete.pdf>.

<sup>11</sup> WCO, Single Window Information Store <http://www.wcoomd.org/en/topics/facilitation/activities-and-programmes/single-window/single-window.aspx>.

<sup>12</sup> Tsen, J.K.T. 2011. *Ten Years of Single Window Implementation: Lessons Learned for Future*. [https://www.unece.org/fileadmin/DAM/trade/Trade\\_Facilitation\\_Forum/BkgrdDocs/TenYearsSingleWindow.pdf](https://www.unece.org/fileadmin/DAM/trade/Trade_Facilitation_Forum/BkgrdDocs/TenYearsSingleWindow.pdf). For more discussion, see Lawrence, R.Z., Hanouz, M. D., and Doherty, S. 2012. *The Global Enabling Trade Report 2012 Reducing Supply Chain Barriers: The Enabling Trade Index 2012* <http://www.news1.co.il/uploadFiles/252620875835419.pdf>; Carballo, J., Graziano, A., Schaur, G., Martincus, C. V. 2016. *The border labyrinth: information technologies and trade in the presence of multiple agencies*. IDB Working Paper Series; 706. Research has shown that single window systems have positive impact on increasing the number of exporting firms and on improving international trade flows. Implementation of streamlined procedures to process export permits through the single window in Costa Rica resulted in an increase in the number of exporters by 22.4%.

<sup>13</sup> World Bank, *Doing Business*. 2017. *Equal Opportunity for All*. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0948-4.

<sup>14</sup> Choi, J. Y. 2011. *A Survey of Single Window Implementation*. WCO Research Paper No. 17. <sup>[17]</sup>

<sup>15</sup> OECD. 2013. *Interconnected Economies: Benefiting from Global Value Chains* <http://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf>.

<sup>16</sup> See note 1.

<sup>17</sup> WTO. 2013. Bali Ministerial Declaration and Decisions [http://wto.org/english/thewto\\_e/minist\\_e/mc9\\_e/balipackage\\_e.htm](http://wto.org/english/thewto_e/minist_e/mc9_e/balipackage_e.htm).

concerning Fees and Formalities connected with the importation and exportation, where paragraph 1(c) recognizes “the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirement”. The single window system under the TFA has to be implemented by the Members of the WTO thereby allowing traders to lodge information with a single body for the purposes of all import or export related regulatory requirements. This system seeks to ensure that all procedures, data and requirements related to the trade transaction is handled and overseen by one agency which takes the responsibility of combined controls. In addition to making the procedural requirements for the traders simple and standardized, this system facilitates information flows enhancing efficiency.

Once the TFA is fully implemented, it will result in an environment where WTO Member States would have an operational Single Window (to facilitate import, export and transit-related regulatory functions) across jurisdictions that will establish the infrastructure for the ISWE. As mentioned above, the concept of the ISWE simply stated refers to an environment which is characterized by interoperability<sup>18</sup> between various national single windows. The interoperable environment reflects the position where national single windows communicate with each other to exchange relevant information. In practice the discussion on ISWE must begin with the deliberation on different technological and organizational models for making interoperability possible. After surveying existing literature it is revealed that two models are proposed for the design of interoperability, namely centralised server model<sup>19</sup> and gateway model.<sup>20</sup> More recently, cloud computing has also been suggested as a way forward to build a supranational single window.<sup>21</sup> The technological framework that is selected for the creation of the ISWE framework may entail distinct legal and political deliberations. If a centralised server model is adopted for ISWE then a central server may be used to host a gateway which will facilitate the trade data exchange. This model seems simple from a practical perspective but it poses problematic political questions. One such question is which Member State will host and be responsible for the maintenance of the central server? The main concern relates to flow of trade-related data between exporting country and importing country transmitted via a third country where the central server is installed. The legal questions pertaining to such a model is connected with data retention, accessibility, archiving etc. The other option is for the Member States’ national single windows to be connected to each other through a common gateway application.

One crucial factor which is central to the concept of interoperability is that the national single windows which will ultimately participate to create the ISWE should actually be able to communicate or exchange the relevant information. Simply stated the single windows must be interoperable. For this purpose, it is important that the relevant international standards be used as guidelines for the implementation of single windows across jurisdictions. The TFA provides to this effect. Article 10.3 of the TFA provides that Members are encouraged to use relevant international standards or parts thereof as a basis for their import, export, or transit formalities and procedures, except as otherwise provided for in this Agreement. It is important to note that there are several important international instruments that have been developed by various international institutions with respect to developing or upgrading single windows. There are three important UN/CEFACT recommendations which is specific to single windows. They are as follows:

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<sup>18</sup> The term “interoperability” is defined as the ability of two or more systems or components to exchange and use information across borders without additional effort on the part of the trader. UN/CEFACT. 2015. *Recommendation and Guidelines on Single Window Interoperability: Supporting Cross Border Interoperability of Trade Regulatory Single Window System: Draft Recommendation No. 36*; Keretho, S., Pikart, M., 2013. *Trends for collaboration in international trade: Building a Common Single Window Environment* ECE/TRADE/411 <https://www.unece.org/fileadmin/DAM/trade/Publications/ECE-TRADE-411.pdf> where interoperability is defined as the ability of diverse systems and organizations to work together.

<sup>19</sup> Centralized Gateway Model” whereby the Gateway is installed in a single Central Server for the common use of all participating countries.

<sup>20</sup> “Distributed Gateway Model” whereby the Gateway is installed separately in the national network perimeter of each participating country.

<sup>21</sup> Pugliatti, L. 2011. Cloud Single Window: Legal Implications of a New Model of Cross-Border Single Window. *World Customs Journal* 5(2):3.



- UN/CEFACT Recommendation 33 defines the concept of single windows and recommends the government to establish single windows.<sup>22</sup>
- UN/CEFACT Recommendation 34 focuses on the issues connected to the implementation of single windows.
- UN/CEFACT Recommendation 35 focuses on legal aspects of single window facilities.

Single windows need to be supported by a legal framework to formalise and induce trust in the emanating transactions in addition to technological or organizational infrastructure.<sup>23</sup> Many of the legal issues pertaining to the establishment and operation of single windows can be addressed through contracts and memoranda of understandings between relevant participants but others can be addressed through recourse to international standards. There are several standards that are relevant in context of single windows which have been developed by intergovernmental agencies and international organizations such as UNCEFACT,<sup>24</sup> UNNEXt<sup>25</sup> and WCO<sup>26</sup>.

It is important that countries seek recourse to international standards so that the single window architecture is interoperable globally. Important legal issues considered by UNCITRAL related to electronic commerce such as authentication, and the legal status of electronic documents are hugely relevant in context of single window operation. It should be noted that UNCITRAL basic e-commerce laws such as the UN Electronic Communications Convention; UNCITRAL Model Law on Electronic Commerce (MLEC); UNCITRAL Model Law on Electronic Signatures (MLES) provides legal framework for the operation of single window facilities. The new Model Law on Electronic Transferable Records is also relevant because the processes connected with single window transactions are electronic but still based on paper.<sup>27</sup>

Once the interoperable environment is set up it will allow for collaborative information sharing for both public and private sector stakeholders in global supply chains. This information will in turn enhance visibility of the supply chain itself and various actors involved in the process. More importantly it has the

<sup>22</sup> UN/CEFACT. 2005. *Recommendation and Guidelines on Establishing a Single Window to Enhance the Efficient Exchange of Information between Trade and Government*, Recommendation No. 33, (ECE/TRADE/352, July 2005). [https://www.unece.org/fileadmin/DAM/cefact/recommendations/rec33/rec33\\_trd352e.pdf](https://www.unece.org/fileadmin/DAM/cefact/recommendations/rec33/rec33_trd352e.pdf)

<sup>23</sup> UN/CEFACT. 2013. *Establishing a legal framework for international trade Single Window (Recommendation No.35)*. [http://www.unece.org/fileadmin/DAM/trade/Publications/ECE-TRADE-401E\\_Rec35.pdf](http://www.unece.org/fileadmin/DAM/trade/Publications/ECE-TRADE-401E_Rec35.pdf).

<sup>24</sup> UN/CEFACT. 2013. *Data Simplification and Standardization for International Trade (Recommendation No.34)*. [http://www.unece.org/fileadmin/DAM/trade/Publications/ECE-TRADE-400E\\_Rec34.pdf](http://www.unece.org/fileadmin/DAM/trade/Publications/ECE-TRADE-400E_Rec34.pdf); UN/CEFACT. 2014. *Revision of Recommendation 14: Authentication of Trade Documents*. [http://www.unece.org/fileadmin/DAM/cefact/recommendations/rec14/ECE\\_TRADE\\_C\\_CEFAC\\_2014\\_6E\\_Rec14.pdf](http://www.unece.org/fileadmin/DAM/cefact/recommendations/rec14/ECE_TRADE_C_CEFAC_2014_6E_Rec14.pdf).

<sup>25</sup> UNNEXt. 2012. *Single Window Planning and Implementation Guide* <http://unnxt.unescap.org/tools/implement-guide.pdf> recommends single window implementation framework SWIF and identifies ten smaller and easier manageable components critical to single window development. The ten components include: identification and management of stakeholder requirements; single window vision articulation; establishment of stakeholder collaboration platform; business process analysis and simplification; data harmonization and document simplification; design of service functions and application architecture; establishment of standards and interoperability; introduction of legal infrastructure; enforcement of business and governance models; execution of IT infrastructure and solutions; UNNEXt, UNESCAP/UNECE. 2012. *Electronic Single Window Legal Issues: A Capacity Building Guide*. <http://unnxt.unescap.org/pub/tipub2636.pdf>; UNNEXt 2012. *Business Process Analysis Guide to Simplify Trade Procedures* <http://unnxt.unescap.org/pub/tipub2558new.asp>; UNNEXt. 2012. *Data Harmonising and Modelling Guide for Single Window Environment*. <http://unnxt.unescap.org/pub/tipub2619.pdf> ; UNNEXt. 2012. *Guide for the design of Aligned Forms for Paperless Trade* [http://www.unece.org/fileadmin/DAM/trade/Publications/ece\\_372\\_ManualForDesignAlignedTradeForms.pdf](http://www.unece.org/fileadmin/DAM/trade/Publications/ece_372_ManualForDesignAlignedTradeForms.pdf).

<sup>26</sup> WCO. 2011. *How to Build SW Environment* <http://www.wcoomd.org/en/topics/facilitation/activities-and-programmes/single-window/single-windowguidelines.aspx#{228E2A1B-6B48-4D59-9FF4-1451CBCF62EC}>; WCO. 2009. *Data Model (version 3.0)* [http://wcoomdpublishings.org/data-model-3.html?id=836&\\_\\_store=english&\\_\\_from\\_store=french](http://wcoomdpublishings.org/data-model-3.html?id=836&__store=english&__from_store=french).

<sup>27</sup> UNCITRAL. 2016. *Draft Model Law on Electronic Transferable Records*. A/CN.9/WG.IV/WP.139, A/CN.9/WG.IV/WP.139/Add.1 and A/CN.9/WG.IV/WP.139/Add.2 <https://documents-dds-ny.un.org/doc/UNDOC/LTD/V16/051/96/PDF/V1605196.pdf?OpenElement>.

potential to meet the requirements of entire international supply chain as opposed to the piecemeal benefit presented by single point data submission at the national level. This will also reduce the volume of trade-related paperwork required of traders by making them shared electronically. Sharing of trade related documents prior to arrival of goods through the ISWE environment would minimise time and costs associated with cargo clearance.

To build the ISWE that complements the highly interconnected international trading scenario, the border agencies need to work together to encompass the entire supply chain where the goods can be assessed for admissibility and clearance prior to their arrival at the physical border. Measures of co-ordination and co-operation range from policy to documentary and physical control amongst domestic and international border agencies. However, the co-operation and co-ordination between international border agencies is based on a political mandate and can manifest through international agreements and ratification of relevant conventions. In this context the proposed TFA's role can be instrumental in achieving the desired result, as it will lead to political commitment from WTO Members because of its multilateral nature. Article 12 of the TFA is a building block in that direction because it emphasises the importance of customs cooperation. It has to be recognized that the cooperation is not easy to achieve as each Member State may have its own requirements and set of rules that need to be harmonized internally as the first step and then build a relationship based on trust with other Member States. Article 12 of the TFA can be helpful from a futuristic perspective when considering the ISWE because it would establish the process and procedures for the purposes of exchange and interaction between border agencies of different jurisdictions.

#### *4. Legal Issues Relevant For ISWE*

##### *4.1. The Legal Basis for Establishing Cross-Border Interoperability*

The interoperability of Single Windows leading up to the creation of ISWE requires a legal basis. Interoperability can be established through a multilateral agreement that would obligate parties to harmonize technical and administrative requirements of their national single windows. Connecting single windows at a multilateral level requires international cooperation and coordination and for that political will is imperative. This may seem a herculean challenge but the advantages of connected environment would steer action in creation of interoperability. Perhaps a TFA style multilateral Framework Agreement may be undertaken through a trade driven institution such as the WTO which could provide the legal basis for ISWE. The pragmatism of a multilateral approach may be contested but after the implementation of the TFA, interoperability is the next step to facilitate trade. Once the economic benefits become clear from regional initiatives such as the ASW, there would be willingness to emulate interoperability at international level.

Another approach could be that interoperability is built at regional level. In such a case there will be several regional interoperable single window environments which may then serve as the building blocks in the grand scheme of creation of ISWE. However, integrating the fragmented regional interoperable environments may present technical and legal challenges. It should be noted that interoperability is guided by the robust structure of national single windows. Therefore, national single windows should be supported by legal frameworks and cross-border exchange of data authorised under national law.

##### *4.2. Identification, Authentication and Authorisation Procedure*

The legal issues related identification, authentication and authorisation are pertinent when considering the interoperability because it ensures that the individuals accessing and participating in the processes of the ISWE have the authority to do so. The lack of universally accepted standard for the electronic signature, authentication approach and authorization procedure can pose significant challenges from legal perspective.

Matters are also complicated by UN/CEFACT Recommendation No. 14 which states that, as far as possible, the requirement of a signature (manuscript or its electronic functional equivalent) should be

eliminated unless it is essential in the context of the transaction.<sup>28</sup> This simply means that a certain authentication method be used depending on the nature of the transaction. For example, a low level authentication may be adequate for certain tasks. This seriousness (associated risk assessment) related with a certain transaction may vary across jurisdictions. In context of authentication methods, it is pertinent that countries which participate in exchange of information between their single windows ensure that their method is reliable and secure for the purposes of information exchange between traders and the local single window. In addition, when countries are exchanging information between single windows then the authentication method must ensure safe and secure cross-border transmission of information.

For ISWE to work, member countries that participate in creation of the environment must agree on a common standard or mutually recognize the standard in information exchange. The question that arises is how can countries achieve this practically? Participating countries may seek recourse to instruments which have been developed by various international institutions such as UNCITRAL,<sup>29</sup> UNESCAP<sup>30</sup> and OECD<sup>31</sup>. The only associated complication is when international standards, model laws and toolkits are implemented in different ways by countries. This in itself can pose a challenge for supporting cross-border transactions. Consider the issue of e-signatures. Although, the importance of concepts of “functional equivalence” and “technological neutrality” has been emphasised in relevant international instruments<sup>32</sup> but countries have adopted different approaches in implementing them in context of e-signatures. Some countries adopt a regulatory approach to e-signatures<sup>33</sup> while the others take a more flexible view.<sup>34</sup> Individually these approaches are fine but in the ISWE context both approaches need to interoperate. Implementing a common standard for identification, authentication and authorization procedures for transactions seem to be most efficient.

#### 4.3. Data Related Issues

##### 4.3.1. Accuracy and Integrity of Data

Interoperability of national single windows will allow exchange of data and for this reason the data has to be accurate, seamless and secure. The accuracy of the data is crucial to the success of the ISWE because it is correlated with the element of trust desired by participants in the ISWE. Business entities demand secure and reliable e-commerce transactions. Ensuring the accuracy and integrity of the data is connected with the responsibility of actors for submitting correct data for the processes in the ISWE which is also connected to the issue of liability. Draft Recommendation 36 indicates that the issue of accuracy and

<sup>28</sup> UN/CEFACT. 2014. *Revision of Recommendation 14: Authentication of Trade Documents*. [http://www.unece.org/fileadmin/DAM/cefact/recommendations/rec14/ECE\\_TRADE\\_C\\_CEFAC2014\\_6E\\_Re c 14.pdf](http://www.unece.org/fileadmin/DAM/cefact/recommendations/rec14/ECE_TRADE_C_CEFAC2014_6E_Re c 14.pdf).

<sup>29</sup> UNCITRAL. 2005. *UN Convention on the Use of Electronic Communications in International Contracts* [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/2005Convention.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2005Convention.html)  
UNCITRAL. 1996. *Model Law on Electronic Commerce* [http://www.uncitral.org/uncitral/uncitral\\_texts/electronic\\_commerce/1996Model.html](http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/1996Model.html); UNCITRAL. 2001. *Model Law on Electronic Signatures* [http://www.uncitral.org/uncitral/uncitral\\_texts/electronic\\_commerce/2001Model\\_signatures.html](http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/2001Model_signatures.html); UNCITRAL. 2009. *Promoting Confidence in Electronic Commerce: Legal Issues on International Use of Electronic Authentication and Signature Methods* [http://www.uncitral.org/pdf/english/texts/electcom/08-55698\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/electcom/08-55698_Ebook.pdf).

<sup>30</sup> UNESCAP. 2016. *Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific*, 2016E/ESCAP/RES/72/4 [http://www.un.org/ga/search/view\\_doc.asp?symbol=E/ESCAP/RES/72/4&Lang=E](http://www.un.org/ga/search/view_doc.asp?symbol=E/ESCAP/RES/72/4&Lang=E).

<sup>31</sup> OECD. 2007. *Recommendation on Electronic Authentication and OECD Guidance for Electronic Authentication* <https://www.oecd.org/sti/ieconomy/38921342.pdf>.

<sup>32</sup> See note 28 for UN/CEFACT instrument and note 29 for UNCITRAL instruments that encourages technological neutrality.

<sup>33</sup> Few countries have prescriptive e-signature laws such as Brazil, India, Israel and Malaysia.

<sup>34</sup> A minimalist approach is adopted by the USA. The two-tier approach that is a hybrid of minimalist and prescriptive approaches is adopted by the European Countries, China and South Korea. For more discussion, refer to ADOBE. *A Global Overview of Electronic Signatures* <https://acrobat.adobe.com/content/dam/doc-cloud/en/pdfs/adobe-global-overview-of-electronic-signatures.pdf>; Spyrelli, C. 2002. Electronic Signatures: A Transatlantic Bridge? An EU and US Legal Approach Towards Electronic Authentication. *Journal of Information Law and Technology* (2) [https://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002\\_2/spyrelli/](https://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_2/spyrelli/).

integrity of data be addressed in the Framework Agreement leading to interoperability. Such a Framework Agreement address issues such as fraud and other behaviour that may impact the effectiveness of the ISWE alongside the associated liability.

#### *4.3.2. Right to Obtain Data; Privacy and Protection of Commercial Transactions*

The treatment of information and right to obtain data varies across jurisdictions. Countries have different policies with respect to public documents. For example, the Swedish approach is different to that of the USA regarding what is considered confidential and what become available as a public document. In addition, it should be noted that important constitutional issues may be connected to the right to obtain data. A differential treatment of information could cause complications when the data is being transferred from one jurisdiction to another.

The issue of data protection and data privacy is an area of concern for the ISWE. Data protection is of fundamental consideration as the consumer loses a degree of control over personal data when provided to the service provider for processing. These issues are quite important because stakeholders involved in the international supply chain demand a certain level security of their data. The stakeholder such as a traders are protective of their trade data because it reflects their business strategy. From an interoperability perspective it is important that ISWE provides for privacy technically but also legally. If one single window shares a trade data with the other single window, then some level of certainty need to be provided for the stakeholders in the sense that there will be no unauthorised access to and dissemination of the data. In addition, some clarification of legal issues arising from private data processing at different geographical locations in the world is also required.

In most cases, data protection and privacy are issues that are addressed nationally. These issues have addressed in a fragmented manner regionally and there is limited harmonisation at an international level.<sup>35</sup> However, commercial secrets, trade data are regulated in many countries which could provide the basis for protection but some sort of minimum standards need to established for the purposes of information sharing.

#### *4.3.3. Data Trails and Electronic Archiving*

Data or information may be required on a later date for the purposes of dispute resolution, etc. Therefore, issues concerning data retention would have to be clarified in context of the ISWE because different countries have different approaches to access to information and transparency which is problematic specially in context of archived data.

#### *4.4. Liability issues*

Liability in context of ISWE may arise because of data processing errors, data breach, wrongful submissions, etc., which may result in loss to party (buyers, shippers, freight forwarders, financial institutions) utilising the operations of ISWE. A party may be held liable for his or her acts or omission which has harmful consequence in context of ISWE. The issue of liability is quite complex because of the cross-border context. For instance, to assess the liability of the party it would be imperative to determine in which jurisdiction the liability is to be determined and what court should consider the dispute and which substantive rules may apply. It is imperative that liability and legal recourse be considered through the contractual arrangement of parties participating in ISWE and also through agreements between the States involved.

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<sup>35</sup> OECD. 2013. *Guidelines on the Protection of Privacy and Transborder Flow of Personal Data* <http://www.oecd.org/sti/ieconomy/oecdguidelinesontheprivacyandtransborderflowsofpersonaldata.htm>; UNCITRAL considered working in this area at its 39<sup>th</sup> Plenary Session in 2006 but prioritized its work on international commercial and trade law over data protection law.

#### 4.5. Dispute Resolution

Dispute resolution mechanism is needed to provide a fast and reliable remedy in case of disputes arising from ISWE operations. The disputes may range from being administrative, civil and criminal in nature. Draft recommendation 36 suggests the inclusion of dispute resolution through arbitration in the Framework Agreement.

#### 5. ASW — A Case Study for Interoperability

ASW creates an interoperable environment which connects and integrates National Single Windows (NSW) of ASEAN Member countries at the regional level.<sup>36</sup> The legal foundation of the ASW can be found in the Agreement to Establish and Implement the ASEAN Single Window,<sup>37</sup> Protocol to Establish and Implement the ASEAN Single Window<sup>38</sup> (Implementation Protocol) and Protocol on the Legal Framework to Implement the ASEAN Single Window<sup>39</sup> (Legal Framework Protocol). Currently the ASW supports the exchange of intra-ASEAN Customs Declaration Document (ACDD) and Certificate of Origin (ATIGA Form D) on a pilot basis among seven Member States and will include exchange of other type of data in the future.<sup>40</sup> Singapore, Malaysia, Indonesia, Thailand, Vietnam have already tested ATIGA Form D using the ASW architecture.<sup>41</sup>

Article 1 of the Legal Framework defines the ASW as an environment where NSW of the Member States operate and integrate. Further, the purpose of the ASW can be deciphered from Article 5 which defines the ASW. The Article provides that the ASW is a regional facility to “enable a seamless, standardized and harmonized routing and communication of trade and customs-related information and data for customs-clearance and release from and to NSW”.<sup>42</sup> It is estimated that the ASW will reduce the cost of trading by 8%.<sup>43</sup>

The ASW architecture is based on the distributed gateway model where the NSW of the ASEAN Member States are connected to the ASW Gateway Application through a secure ASW network. This ASW Gateway Application is regionally developed and installed by each Member State. In addition, the centralized regional services support the interaction of the MSWs. It is a facility which administrates and maintains standard formats, codes and other basic information of ASW.

The quantifiable benefits of interoperability in context of the ASW still remains to be seen as and when more data is available.<sup>44</sup> However, the expected benefits of the ASW will be for both governments and business. For example, the pre-arrival information received will enable expedited movement of goods that would benefit traders. It will also allow the border authorities to apply risk management procedures more efficiently. Most importantly, ASW has the potential to harmonise and streamline national procedures that will be beneficial for businesses.

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<sup>36</sup> Several ASEAN countries such as Singapore, Malaysia, Indonesia, Thailand, Vietnam and Philippines have already developed and implemented the NSW system. Brunei, Lao, Cambodia and Myanmar have not implemented Single Windows.

<sup>37</sup> Signed on 9 December 2005. [http://asean.org/?static\\_post=agreement-to-establish-and-implement-the-asean-single-window-kuala-lumpur-9-december-2005-2](http://asean.org/?static_post=agreement-to-establish-and-implement-the-asean-single-window-kuala-lumpur-9-december-2005-2).

<sup>38</sup> Signed on 20 December 2006. <http://asean.org/wp-content/uploads/images/archive/23084.pdf>.

<sup>39</sup> Signed on 9 September 2015. <http://agreement.asean.org/media/download/20150915020056.pdf>.

<sup>40</sup> ASEAN Website: <http://asw.asean.org/>.

<sup>41</sup> ASEAN Website: <http://asw.asean.org/about-asw>.

<sup>42</sup> Article 5, Protocol on the Legal Framework to Implement the ASEAN Single Window

<sup>43</sup> It is indicated that a large portion of saving is attributed to the reduction in documentation dispatch. UNNExT, *Towards an Enabling Environment for Paperless Trade-ASEAN Single Window: A Regional Single Window for ASEAN Connectivity*, Brief No. 13, May 2015. <http://www.unescap.org/resources/unnext-brief-no-13-asean-single-window-regional-single-window-asean-connectivity>.

<sup>44</sup> Please refer to the joint paper by Basu Bal, A., Rajput, T. and Alizada P., *International Single Window Environment: Prospects and Challenges* presented at the ADBI Conference on 28-29 November 2016 (forthcoming ADBI Working Paper publication).



Currently, there are several challenges for a fuller implementation of ASW both from participation and functional perspectives. The first challenge is that ASEAN Member States are at different levels of economic development. Some of the Member States do not have a single window yet which can be integrated into the ASW environment. Implementing a single window at the national level is a matter of resources, expertise and national priority and political will.

The second challenge is that the ASEAN Member States have their own customs regimes and laws governing issues relevant for their respective NSW. This can pose a challenge for interoperability and legal certainty. The notion of legal certainty has been in demand since centuries with respect to the commercial transactions. The quest for induction of the *ubi commercium, ibi ius* has been the propelling force towards emergence of commercial customs and emergence of institutions for the settlement of commercial disputes.<sup>45</sup> In other words, the Latin adage reflects the insight that the efficiency of markets and trade depend on legal certainty. In the context of the ASW, the notion of legal certainty is related to the ability of the businesses to predict and ascertain the meaning and effect of the legal framework. The hope is that a predictable rule oriented framework of the ASW will reduce risk associated with cross-border trade processes for businesses. In the same context, the success of the ASW will depend on how legal regimes of ASEAN Member States interoperate, especially to support cross-border transactions. In addition, some other legal issues crucial for providing the legal framework such as functional equivalence of paper and electronic documents, mutual recognition of digital signatures, etc. still need to be addressed.

For the future of ASW some interesting suggestions have been put forward. The first and foremost concerns the enlargement of scope of regional transactions for cross-border exchange of data within ASEAN and also between ASEAN and its dialogue partners. Other suggestions made in the same report are implementing the ASEAN Customs Transit System for the exchange of data in a single transit declaration directed to facilitate free movement of goods within the region; and launching a central trade repository for trade related information that can be accessed by traders.<sup>46</sup>

An important aspect that merits consideration with respect to the ASW is the identification of key stakeholders. The identification is important because it will help in developing a business model for that can support the architecture's operation and maintenance. UN/CEFACT Recommendation and Guidelines on Single Window Interoperability No. 36 also highlights the importance of identification of stakeholders.<sup>47</sup> The draft Recommendation indicates that it is crucial to identify what stakeholders require from interoperability for the assessment of feasibility. In such a case stakeholders' needs become the key drivers of the system. Identification of the role and benefits of stakeholders of the ASW is crucial for its success. Once the stakeholders and their needs are identified, a suitable business process<sup>48</sup> can be built for the operation and maintenance of the ASW.

## 6. *Integration Of Commercial Requirements In ISWE And Role of UNCITRAL*

The discussion on stakeholders brings us to the consideration about the scope of ISWE. The question that arises is: whether the ISWE environment should focus primarily on trade regulatory issues? This question is of tremendous important because the arguable merit of implementing an ISWE is for creating an information channel which would address the entire supply chain. However, the ISWE which is primarily driven by has trade regulatory processes and data would entail the flow of G2G, B2G data which is not

<sup>45</sup> Petersmann, E.U.2006. Justice as Conflict Resolution: Proliferation, Fragmentation, and Decentralization of Dispute Settlement in International Trade. *University of Pennsylvania Journal of International Economic Law* 27(2) 273.

<sup>46</sup> UNNExT.2015. *Towards an Enabling Environment for Paperless Trade-ASEAN Single Window: A Regional Single Window for ASEAN Connectivity* Brief No. 13.

<sup>47</sup> UN/CEFACT.2015. *Draft Recommendation and Guidelines on Single Window* (Recommendation No.36) [http://www1.unece.org/cefact/platform/download/attachments/48562914/150424+Rec36+Internal+Review+v1\\_1.pdf](http://www1.unece.org/cefact/platform/download/attachments/48562914/150424+Rec36+Internal+Review+v1_1.pdf).

<sup>48</sup> UN/CEFACT Rec. 36 defines business processes "as the way participants intend to play their respective roles, establish business relations and share responsibilities to interact efficiently with the support of their respective information systems".

inclusive of the entire supply chain operations. It is submitted that the full potential of ISWE can be realized through integration of G2G, B2G and B2B information which is possible through the interoperability between single windows that include transport and commercial requirements. It is further submitted that the commercial aspects of international trade when enmeshed with transport requirements in the single windows at the country level will form the building block for an ISWE which will encompass G2G, B2G and B2B interactions. The single windows thus proposed should function as an interface between trade, customs and transport stakeholders by developing extensive inter-linkages to share information. Such integration will allow flow of real-time data that can offer numerous possibilities to enhance the visibility of international supply chains. The inclusion of the commercial and transport requirements in the ISWE will entail the participation of transport stakeholders such as carriers, shippers, ports, transport authorities, insurance providers, etc. The participation of such stakeholders is necessary to make the integration of G2G, B2G and B2B information possible.

Regulatory aspects of transport requirements have already been included in certain national single window systems to fulfil reporting and/or customs requirements. For example, the EU Maritime Single Window initiative simplifies and harmonizes the administrative procedures applied to maritime transport by making electronic transmission of information standard and also rationalizes ship-reporting formalities.<sup>49</sup> It is noteworthy that the commercial and financial aspects of international trade which are enmeshed with transport are not captured through the existing transport oriented single window initiatives. The inclusion of the commercial aspects in existing transport single windows is understandable as addition of various transport stakeholders into the single window system would require complex coordination that can capture the prevalent relationships between carrier interests, shipper interests, ports, transport authorities, insurance providers, etc., from legal and technical perspectives.

The question arises how can commercial and financial aspects of international trade connected with transport be included alongside the regulatory transport requirements in the ISWE. In the above context it is submitted that the emergence of blockchain, federated cloud computing and distributed ledger technology has opened up the possibilities for creating technical solutions for the complex arrangements of stakeholders in the transport industry. However, it should be noted that the enabling legal framework to support these technologies remains incomplete across jurisdictions.

The issue of dematerialization of transport and commercial documents is another challenge. In this respect, the contribution of UNCITRAL on the issue of dematerialisation of bill of lading is well settled. To illustrate, A bill of lading performs three functions, namely, it serves as evidence of the contract of carriage, acts as receipt for the goods, and is a document of title. The first two functions are easily replicated electronically as they essentially relate to transfer of information. The challenge lies in replicating the document of title function electronically which has implications under contract and property law. The Governing Framework Approach which has been created by UNCITRAL and CMI has settled the issue of dematerialization of bill of lading. The two relevant instruments are Rotterdam Rules and Model Law on Electronic Transferable Records.

The more pertinent question that arises is how can the relevant dematerialised information be channelized to fulfil the trade functions in an electronic business environment? It is submitted that the dematerialised information can be channelized to fulfil the trade functions in an electronic business environment through an information exchange channel. The ISWE can serve as information exchange infrastructure through which dematerialised information be channelized to fulfil the trade functions in an electronic business environment to facilitate the entire supply chain. However, for the ISWE to function as an information interchange channel, it should support trusted transboundary electronic interaction.<sup>50</sup> Trusted transboundary electronic interaction is possible if interoperability is agreed at political, legal,

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<sup>49</sup> The Reporting Formalities Directive 2010/65/EU requires all EU Member States to establish National Single Windows (NSW) to enable ships to report formalities when arriving in and/or departing from EU ports.

<sup>50</sup> See UNECE. 2016. *Recommendation for Ensuring Legally Significant Trusted Transboundary Electronic Interaction*  
<https://www2.unece.org/cefact/display/uncefactpublic/Recommendation+for+ensuring+legally+significant+trusted+transboundary+electronic+interaction>.

organizational, semantic and technical levels. It should be noted that large enterprises have already achieved trusted transboundary electronic interaction contractually. Large enterprises use electronic data interchange (EDI) provided by large logistics service providers, such as DHL or UPS. These large logistics service providers have their enterprise resource planning (ERP), transport management and logistics systems that are connected to the ERP system of the large enterprise at one end and with customs and port authorities interface on the other end.<sup>51</sup> This set up excludes entities that do not have advanced internal ERP systems and do not use the services of such large logistics service providers.

The issue of legal interoperability of trust has to be aligned through a supporting legal framework so that exchanged data through the ISWE is accorded proper legal weight across jurisdictions. The ISWE needs to be supported by a legal framework for trusted transboundary transaction. UNCITRAL may serve as a forum to create such legal framework for establishing necessary level of trust between the participants of the trusted infrastructure that will ensure legal significance of transboundary electronic exchange of data issued in different jurisdictions. In this context UNCITRAL could make a significant contribution through its work on trust and identity management. In 2015, several proposals were submitted to UNCITRAL recommending that it undertake a project to develop a basic legal framework covering identity management and trust services as well as of cloud computing to facilitate international cross-border interoperability.<sup>52</sup> Working Group IV has now been tasked to move forward with such a project.<sup>53</sup> Also, organizational interoperability and semantic interoperability will require preparation of recommendations that can be agreed and understood by all parties. UN/CEFACT may take a leading role to prepare recommendations on how to build and manage national trust infrastructures in a best way so they would be interoperable with each other for trade facilitation.

Another effort worth noting is the Framework Agreement on Facilitation of Cross-Border Paperless Trade in Asia and the Pacific,<sup>54</sup> which was adopted by UN/ESCAP and is open for signature from 1 October 2016. Article 1 of the Agreement states that the objective is to facilitate cross-border paperless trade by enabling data exchange and mutual recognition of electronic trade data among willing ESCAP member States through dedicated intergovernmental framework to develop legal and technical solutions. This Agreement provide ESCAP member States with a digital complement for better implementation of the WTO TFA as well as on-going bilateral and sub-regional initiatives, such as the ASW. Article 5 of the Agreement sets out the general principles to facilitate interoperability between paperless trade systems and to ensure that solutions developed under the agreement lead both to higher levels of trade facilitation and regulatory compliance. Article 12 provides a comprehensive action plan to develop standardized solutions and protocols for cross-border electronic exchange and recognition of trade-related data and documents, including pilot projects. UNCITRAL participated in the drafting process of the Agreement with a view to ensuring its consistency with UNCITRAL texts on e-commerce.<sup>55</sup>

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<sup>51</sup> Gleaned from discussions with Abhinayan Basu Bal, Assistant Professor, Department of Law, University of Gothenburg, Sweden.

<sup>52</sup> See in general UNCITRAL — *Report of Working Group IV (Electronic Commerce) on the work of its fifty-third session* (A/CN.9/869); *Legal Issues Related to Identity Management and Trust Services* (A/CN.9/891); *Possible future work in the area of electronic commerce — legal issues related to identity management and trust services — Proposal by Austria, Belgium, France, Italy and Poland* (A/CN.9/854); *Overview of identity management — Background paper submitted by the Identity Management Legal Task Force of the American Bar Association* (A/CN.9/WG.IV/WP.120); *Online dispute resolution for cross-border electronic commerce transactions: Submission by the Russian Federation* (A/CN.9/WG.III/WP.136); and *Possible future work in the area of electronic commerce — Contractual issues in the provision of cloud computing services — Proposal by Canada* (A/CN.9/856).

<sup>53</sup> See UNCITRAL. 2016. *Report of the United Nations Commission on International Trade Law on the work of its forty-ninth session* (A/71/17) 48.

<sup>54</sup> <http://www.unescap.org/resources/framework-agreement-facilitation-cross-border-paperless-trade-asia-and-pacific>.

<sup>55</sup> See note 54 above.



## 7. *Concluding Remarks*

TFA's entry into force may serve as impetus to engage in the preparation of a multilateral Framework Agreement to provide the legal basis for ISWE. UNCITRAL has recently started work on identity management and trust services as well as cloud computing to facilitate cross-border interoperability. In the coming years this effort may ensure legally significant trusted transboundary electronic interaction to include the commercial and transport aspects in ISWE.

The efforts of various international institutions discussed above indicate that trade facilitation initiatives have picked momentum across the globe. What may be found in all such initiatives are a number of interwoven commercial and trade law issues that may need to be addressed. If UNCITRAL has to be relevant as an institution engaged in the modernization and harmonization of rules on international business in the digital era it should co-operate with other international institutions engaged in facilitating trade. This is because UNCITRAL rules only provide a piece of the puzzle of international trade in the digital era. Both public and private law initiatives are relevant in context of single window, paperless trade and e-commerce issues. It is suggested that deeper cooperation between UNCITRAL, WTO, UNNeXT, WCO, UN/CEFACT can create synergetic norms in the area of both public and private law for facilitating trade in the digital era. UNCITRAL has the potential to support ISWE by providing a strong law framework that would contribute to achieve SW interoperability and enhanced information management. In addition, UNCITRAL's work must focus on build an inclusive trading environment in particular for the SME's and for that it must continue to lay emphasis on equality of opportunities for business actors participating in international trade.

## *Logistics Contracts: Outdated International Regulation?*

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### *Introduction*

As the title suggests, the main issue of this paper is to raise the question of whether the current international legal framework is fitted to rule over Logistics Contracts (LCs)<sup>1</sup> or not, analysing its nature as a *Sui Generis*<sup>2</sup> one, with its own identity and distinct from other commercial contracts.

It is important to highlight the key role that UNCITRAL<sup>3</sup> may have on the regulatory harmonisation process for LCs. It seems to be the natural institution to coordinate and boost the potential modifications over the current international legal framework regarding them.

In this paper, LCs will mean : *those commercial contracts by which logistics services providers perform “logistics services” such as transport, warehousing, handling of goods in general (among others) to cargo owners (usually producers of goods).*

Nowadays the international logistics services providers offer a wide range of services to meet the needs of international trading companies on a worldwide basis. Cargo owners need someone with expertise to treat their goods in an efficient way to enable the final delivery for consumption and as a consequence of that, logistics operators have become more aware of their clients' needs usually assuming the role of real partners in their businesses.

Within this document those companies moving freight around the world will be broadly called “Logistics Operator” (LO)<sup>4</sup> with a focus on big LCs handling a significant number of goods.

In order to shed light on the potential need of specific international regulation and probably some harmonization as well, the first stage of the analysis will allow to assess whether or not LCs should be considered as *Sui Generis* contracts even when the doctrine and most of the national and international regulations do not give this special categorization to them.

The intention of this document is to highlight the importance of logistics as an economic activity in a global international trade context and to provide the reader with some key elements which might enable him to consider the LC as an independent commercial contract with a *Sui Generis* nature. It will take into account the potential inefficient or insufficient regulation for these contracts in some local jurisdictions and international conventions.

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<sup>1</sup> Or “LCs” for plural.

<sup>2</sup> C. O. S Mawson, *Dictionary of Foreign Terms*, (2 ed., New York: Thomas Y. Crowell Company, ISBN 0-690-00171-1, 1975, p.328): “*Sui Generis*: Of its (his, her, or their) own kind; in a class by itself; unique”.

<sup>3</sup> United Nations Commission on International Trade Law.

<sup>4</sup> Or “LOs” for plural.

## Chapter 1: Logistics, Pure logistics services and LC concept

### Section 1.1: Logistics Concept

Etymologically, the word “logistics” comes from “logisticus”<sup>5</sup> (Medieval Latin) meaning “of calculation” and from the Greek “logistikos”<sup>6</sup> (λογιστικός), meaning “skilled in calculating” while the Oxford dictionary on-line defines it as “the detailed organization and implementation of a complex operation”<sup>7</sup>.

Moreover, the European Logistics Association defines it as “the organization, planning, control and execution of the goods flow from development and purchasing, through production and distribution, to the final customer in order to satisfy the requirements of the market at minimum costs and capital use”<sup>8</sup>. The modern concept of logistics derives from the French “logistique”<sup>9</sup> as France was one of the first countries to implement the term in the way it is recognized nowadays.

Within the commercial field, until the early 80’s, transportation of goods, their distribution and the different systems of warehousing, were organized in a relatively independent way.

As the world became more globalized, the different processes of production that had been implemented among different countries geographically located in distant parts of the planet ended up in a more cohesive reality.

Nowadays, it can be affirmed that logistics is the major enabler of our economy and lifestyle.

All the goods manufactured need to be located close to consumers and most of the time this task is usually a really complex one.

Furthermore, regarding the European Union countries, the 2015 Report of the European Commission, affirmed that the whole European logistics market size (including the EU28 countries) amounted to about € 878 bn in 2012.<sup>10</sup>

These brief references clearly show the importance of the logistics activity in the commercial markets of those jurisdictions considered in the present document.

Therefore, it is clear that during the last decades the concept of logistics has been modified in order to provide a comprehensive service to cargo owners.

The traditional services of carriage of goods and warehousing are no longer considered as individual services when a complex logistics operation system is implemented. Indeed there are much more tailor made services particularly linked to them and of a pure logistics nature that the LO performs in order to offer general handling of goods within a certain timeframe according to the requirements of the cargo owner. Regarding the extension of this paper, the contracts of Carriage of Goods and Warehousing, which are almost always present on LCs, are not going to be discussed.

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<sup>5</sup> Love to Know Corp. — Your Dictionary, ‘Logistic’ definition: <<http://www.yourdictionary.com/logistic>> accessed 30 July 2016.

<sup>6</sup> E. H. Pflugfelder, *Communicating Mobility and Technology, a material rhetoric for persuasive for transportation*, (Routledge. Pg. 87).

<sup>7</sup> Oxford University Press — Oxford Dictionary, ‘Logistics’ definition: <<http://www.oxforddictionaries.com/definition/english/logistics>> accessed 30 July 2016.

<sup>8</sup> Concargo Pty (Ltd), ‘Definition of Logistics’: <<http://www.concarga.com/client-lounge/definitions/logistics/>> accessed 30 July 2016.

<sup>9</sup> Larousse Dictionary, ‘Logistique’ definition: <<http://www.larousse.fr/dictionnaires/francais/logistique/47678>> accessed 30 July 2016.

<sup>10</sup> European Commission Report, ‘Logistics and Multimodal Transport’: <[http://ec.europa.eu/transport/themes/logistics\\_multimodal/logistics/index\\_en.htm](http://ec.europa.eu/transport/themes/logistics_multimodal/logistics/index_en.htm)> accessed 30 July 2016.

These are regulated contracts in the international framework and later on some brief references will be provided. Instead, pure logistics services will be described as follows.

### *Section 2.1: Pure logistics services: Brief overview*

#### *Sub-Section 2.1.1: Cross Docking<sup>11</sup>*

Cross Docking can be defined as a logistics service:

[W]here products from a supplier or manufacturing plant are distributed directly to a customer or retail chain with marginal to no handling or storage time. Cross docking takes place in a distribution docking terminal; usually consisting of trucks and dock doors on two (inbound and outbound) sides with minimal storage space. The name ‘cross docking’ explains the process of receiving products through an inbound dock and then transferring them across the dock to the outbound transportation dock.<sup>12</sup>

In order to implement this particular service as a logistics operation, it is important for the cargo owner to analyse how it will impact on the improvement of his business.

Some classic examples to implement this logistics model are cases in which food is involved. Food needs to be kept at a certain temperature and to be transported within a short time-frame. For cases involving already packaged goods which need to be delivered to certain clients of the cargo owner on a regular basis under specific instructions which are usually non compatible with normal storage of goods, Cross Docking is deemed as a really interesting logistics solution.

#### *Sub-Section 2.1.2: Material handling (picking)<sup>13</sup>*

The material handling of the goods is an essential service in every logistics operation.

It means the general classification, allocation and particularly the way by which goods will be “collected” when dispatch is necessary.

There are different “systems” by which these tasks can be performed by the LO and certain software will be always necessary to implement them. It will depend on which software is available to determine which system can be implemented regarding each particular LC.

#### *Sub-Section 2.1.3: Packaging, Inventory and Security*

- Packaging: The cargo owner may not have the expertise to assume the role of “allocating” the goods to the correct path and it could be costly to prepare the goods either for consumption or storage.

The LO will contribute to allocated the goods either for storage or final consumption.

This service is usually associated with other logistics services and it is an important part of most LCs.

The process of treatment of scrap is usually linked to this service of logistics operations.

- Inventory:<sup>14</sup> Inventory costs are usually a big concern of every cargo owner and LO.

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<sup>11</sup> Adaptalift, ‘Logistics and Materials Handling Blogs’ : <[http://www.aalhysterforklifts.com.au/index.php/about/blog-post/what\\_is\\_cross\\_docking\\_understanding\\_the\\_concept\\_definition](http://www.aalhysterforklifts.com.au/index.php/about/blog-post/what_is_cross_docking_understanding_the_concept_definition)> accessed 30 July 2016.

<sup>12</sup> Ibid.

<sup>13</sup> The Logistics Business Ltd., ‘Order Picking: How efficient is your system?’ : <<http://www.logistics.co.uk/order-picking-how-efficient-is-your-system/>> accessed 30 July 2016.

<sup>14</sup> The Logistics Business Ltd., ‘Inventory Optimization’: <<http://www.logistics.co.uk/products/inventory-optimisation/>> accessed 30 July 2016.

From the cargo owner perspective, he is trusting the LO to handle his goods during a certain period of time on a specific route and he wants to have total control of what is going on during the storage stage.

From the perspective of LOs, it is a big concern since he assumed the liability in case of any loss or damage and he will be interested in keeping a certain control over his stock.

Different software is used for these aims and details will depend on each single LC.

- Security: Security services are often being offered by LOs as a complement of the main logistics services since cargo owners are concerned about the security of their goods.

Even when the LO assumes his duty of care over the goods, there are some circumstances in which, even when insurance policies had been obtained for that specific purpose, the cargo owner will be happy to know that security services can strengthen the preservation of his goods.

### *Section 3: LC Concept*

As previously defined, the LC is as a commercial contract by which the LO agrees to perform certain logistics services in favour of the cargo owner for consideration.

Regarding the logistics services mentioned in the provided definition, it is important to highlight the fact that it will depend on the requirements of each cargo owner. Furthermore, there are some services that are mainly present on every LC: these are the traditional carriage of goods and warehousing services which are going to be discussed later on.

On the other hand, all those logistics services exclusively provided by the LO have been examined as well. Those services basically consist of the handling of goods in a certain way that permits to allocate them within a certain timeframe and way as already instructed by the cargo owner. It is important to mention that the scope of the services included in the LC is not always clearly described on it and sometimes certain issues can arise during the term of the contract related with certain common confusions usually from the cargo owner's perspective.

A good example could be within the service of warehousing<sup>15</sup>. Worldwide cargo owners usually consider that this service includes a comprehensive service of the handling of goods. It is an 'all inclusive' service since the goods stay at the warehouse up to the moment that they are picked up. On the contrary, for the LO this service means just the service of storage of goods. Additional services involving handling should be clearly provided on the contract in order to avoid any kind of misunderstanding.

Even when the LC is tailor made for every particular case, there are certain clauses that are always present on every single LC — or should be — and somehow these can be deemed as "mandatory" elements for any LC.

Considering the required limitations regarding the extension of this paper some of them will be just mentioned as follows: Minimum volumes, Liability for damages of the Goods clauses<sup>16</sup>, KPI (Key Performance Indicators)<sup>17</sup>, Contract term and termination clause<sup>18</sup>, Choice of law and Court clause<sup>19</sup> and the Insurance clause<sup>20</sup>.

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<sup>15</sup> DSV, 'Logistics Contract Negotiation': <<http://www.uk.dsv.com/logistics-solutions/Expert-Insights/Logistics-Contract-Negotiation>> accessed 30 July 2016.

<sup>16</sup> See n 15.

<sup>17</sup> Oxford University Press — Oxford Dictionary: 'Key Performance Indicator' definition: <<http://www.oxforddictionaries.com/definition/english/key-performance-indicator>> accessed 30 July 2016.

<sup>18</sup> See n 15.

<sup>19</sup> See n 15.

<sup>20</sup> See n 15.

## Chapter 2: LC Regulation: International Overview

### Section 2.1: International Approach

The LC can be analysed from a local approach within different jurisdictions but as there is usually an international element in every big logistics operation — even more when our work is focusing on big LOs — the relevant international legal framework will be highlighted in this section.

As Diplock LJ stated in the English *Fothergill* case<sup>21</sup> supporting the idea that international conventions should be interpreted considering the international origins of the rules and not being limited by the rigid local legislations,<sup>22</sup> regardless of the factual possibility of applying different legal approaches for international LCs, when analysing the international framework for LCs in detail, there is no direct reference to this contract among the current international conventions.

Therefore it can sometimes be difficult to adapt certain legal concepts and rules extracted from regulations aimed to rule on different commercial contracts such as international carriage of goods.

Firstly, it is necessary to highlight once again the idea that, within most of the European countries the LC has not being considered as such by local regulations and somehow, as a result of that, international conventions are mostly not even applying the concept of “logistics”.

It is interesting to consider the Swedish approach in regards to this issue since the question of the possibility of applying international conventions on carriage of goods to LCs has been strongly debated in Scandinavian legal literature<sup>23</sup> and is yet unresolved by case law<sup>24</sup>.

Within the European international context, two different legal conceptions seem to coexist when considering the nature of LCs.

According to one of them the LC is mainly a contract of carriage of goods with additional services and according to the other one the LC is a totally different contract from the carriage of goods by which different logistics services are efficiently settled and performed following certain instructions of the cargo owner and in a certain timeframe.

The latter approach seems to be more comprehensive considering how the LC works in real legal practice nowadays. Furthermore, as will be described later, German Standard Terms for contracting usually apply a similar approach categorizing the LC under the concept of “mixed contracts”<sup>25</sup>. Thus, rules for carriage of goods will apply for the actual performance of carriage under the scope of the LC and other specific regulations will apply for those other services considered under the LC such as warehousing, security, etc.

As mentioned above, within the international framework it is hard find even a brief reference to the “logistics” activity. This is the case since, even though this industry has become a key aspect of the international economic activity, most legal practitioners and LOs are still considering LCs either as a

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<sup>21</sup> *Fothergill v Monarch Airlines Ltd* — House Of Lords 2 [1981] AC 251; [1980] 2 All ER 696; [1980] 3 WLR 209; [1980] 2 Lloyd's Rep 295, (33 ICLQ 797): “The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English Judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament that deals with purely domestic law. It should be interpreted as Lord Wilberforce put it in *James Buchanan & Co*”.

<sup>22</sup> M. Hoeks, ‘Multimodal Transport Law: The Law Applicable to the Multimodal Contract for the Carriage of Goods’, (Kluwer International 2010, pg. 134).

<sup>23</sup> V. Ulfbeck: ‘Contracts of Logistics under the Rotterdam Rules’, (The journal of International Maritime Law, Vol. 17, 2011, p. 219).

<sup>24</sup> Ibid., (p. 220).

<sup>25</sup> Ibid., (p.221).

contract of carriage of goods and/or a warehousing one; and the lack of specificity in international regulations seems to reflect that.

Among the main international conventions that are nowadays applied to LCs the following regulations are usually considered:

- Hague Visby Rules<sup>26</sup> and Hamburg Rules<sup>27</sup>: may apply to international carriage of goods by sea where LOs and/or cargo owners are based on signatories countries of these conventions depending the scope of each particular LC. The limits of liability stated on the Hague Visby Rules are usually taken into account by the parties when analysing pros and cons among other aspects.<sup>28</sup>
- International Convention of Multimodal Transport 1980 United Nations Convention on International Multimodal Transport of Goods (Geneva, 24 May 1980) United Nations (UN) (ICMT): The ICMT seems to be the first international attempt to consider global and complex logistics operations by considering different means of transport for international carriage of goods contracts. Its art. 1 defines the “international multimodal transport” as: “*the carriage of goods by at least two different modes of transport on the basis of a multimodal transport contract from a place in one country at which the goods are taken over by the multimodal transport operator to a place designated for delivery situated in a different country*”.

Even though this convention is not taking a comprehensive approach in relation to international logistics, since it only refers to the international carriage of goods, it is necessary to recognize that, ruling on different means of transport, contributed to shed light on the legal framework of international logistics which usually includes more than one means of transport.

- Convention on the Contract for the International Carriage of Goods by Road (CMR) — (Geneva, 19 May 1956) United Nations (UN):<sup>29</sup> Regarding transportation of goods by road, the Convention for the CMR applies to almost all the transportation of goods within the countries of the EU.<sup>30</sup>
- United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea (Rotterdam Rules 2009): The Rotterdam Rules need to be mentioned as part of this section since, even when they have not been enforced yet, it is the most recent convention aimed to govern the international carriage (totally or partly) by sea which is a key means of transport usually included in international LCs.

<sup>26</sup> The Hague-Visby Rules — The Hague Rules as Amended by the Brussels Protocol 1968. Article X: “*The provisions of these Rules shall apply to every bill of lading relating to the carriage of goods between ports in two different States if (a) the bill of lading is issued in a contracting State, or (b) the carriage is from a port in a contracting State, or (c) the contract contained in or evidenced by the bill of lading provides that these Rules or legislation of any State giving effect to them are to govern the contract; whatever may be the nationality of the ship, the carrier, the shipper, the consignee, or any other interested person*”.

<sup>27</sup> United Nations Convention on the Carriage of Goods by Sea (Hamburg, 1978) (the “Hamburg Rules”) Article 2. Scope of application 1: “*The provisions of this Convention are applicable to all contracts of carriage by sea between two different States, if: (a) the port of loading as provided for in the contract of carriage by sea is located in a Contracting State, or (b) the port of discharge as provided for in the contract of carriage by sea is located in a Contracting State, or (c) one of the optional ports of discharge provided for in the contract of carriage by sea is the actual port of discharge and such port is located in a Contracting State, or (d) the bill of lading or other document evidencing the contract of carriage by sea is issued in a Contracting State, or (e) the bill of lading or other document evidencing the contract of carriage by sea provides that the provisions of this Convention or the legislation of any State giving effect to them are to govern the contract*”.

<sup>28</sup> See n 21.

<sup>29</sup> International Carriage of Goods by Road (CMR) — (Geneva, 19 May 1956) United Nations (UN): Chapter 1 — Scope of Application, Article 1 1: “*This Convention shall apply to every contract for the carriage of goods by road in vehicles for reward, when the place of taking over of the goods and the place designated for delivery, as specified in the contract, are situated in two different countries, of which at least one is a contracting country, irrespective of the place of residence and the nationality of the parties.*”

<sup>30</sup> B. Soyer and A. Tettenborn: ‘Carriage of goods by sea, land and air: unimodal and multimodal transport in the 21st century’, (Abingdon: Informa Law, 2014, pg.254).

The inclusion of the possibility of warehousing on the Port Terminal<sup>31</sup> can be considered as an important progress of ruling over LCs. It seems to be the first time that carriage of goods has not been regulated by an isolated contract as was the case on previous occasions. As a consequence, the wording of this convention can be deemed to be a closer approach to logistics operations as they are actually performed nowadays.

Regardless of that, several problems have been detected regarding some mandatory rules that this convention imposes on the cargo owner/shipper such as “*delivery ready for carriage*”<sup>32</sup> or the mandatory rule about providing information of the goods.<sup>33</sup> Therefore, if one of the main features of the Rotterdam Rules was to transfer liability from the cargo owner/shipper to the LO, these rules are likely to raise different legal issues especially in those cases where logistics services have been totally outsourced by the LO. Some examples are the lack of “necessary information” by the cargo owner/shipper for the general handling of the goods or the factual impossibility of the cargo owner/shipper to do the “delivery ready for carriage”<sup>34</sup> when all the packaging is undertaken by the LO.

Considering the required limitations regarding the extension of this paper, it is not possible to provide details of different local approaches. Regardless of that, jurisdictions such as France<sup>35</sup>, England, Germany<sup>36</sup>, Sweden<sup>37</sup> and Uruguay<sup>38</sup> have been researched and it is necessary to mention that there is currently no local legal system including a particular regulation on LC's. Instead, the rules on the contracts of carriage of goods and warehousing will generally apply to LCs.

### Chapter 3: Specificity of the LC Object

As was mentioned previously there are different services included on every LC. At least either the service of carriage of goods or warehousing will be always present in a LC.

<sup>31</sup> Rotterdam Rules: Art. 1.7: “*Maritime performing party: A performing party to the extent that it performs or undertakes to perform any of the carrier’s obligations during the period between the arrival of the goods at the port of loading of a ship and their departure from the port of discharge of a ship. An inland carrier is a maritime performing party only if it performs or undertakes to perform its services exclusively within a port area*”.

<sup>32</sup> Rotterdam Rules. Art. 27: “*Unless otherwise agreed in the contract of carriage, the shipper shall deliver the goods ready for carriage. In any event, the shipper shall deliver the goods in such condition that they will withstand the intended carriage, including their loading, handling, stowing, lashing and securing, and unloading, and that they will not cause harm to persons or property*”.

<sup>33</sup> Rotterdam Rules Art. 29: “*Shipper’s obligation to provide information, instructions and documents: 1. The shipper shall provide to the carrier in a timely manner such information, instructions and documents relating to the goods that are not otherwise reasonably available to the carrier, and that are reasonably necessary: (a) For the proper handling and carriage of the goods, including precautions to be taken by the carrier or a performing party; and (b) For the carrier to comply with law, regulations or other requirements of public authorities in connection with the intended carriage, provided that the carrier notifies the shipper in a timely manner of the information, instructions and documents it requires. 2. Nothing in this article affects any specific obligation to provide certain information, instructions and documents related to the goods pursuant to law, regulations or other requirements of public authorities in connection with the intended carriage*”.

<sup>34</sup> See n 60 (p.221-222).

<sup>35</sup> Khezami S., ‘Le Contrat de Logistique’, (Centre de Droit Maritime et des Transports, Université de Droit D’économie et des Sciences D’Aix — Marseille); Kembeu J., ‘Le contrat de prestations logistiques, contrat complexe ou contrat sui generis? Etude de la notion et du régime du contrat de prestations logistiques’, (14ème Journée doctorale en transport, Ecole Nationale des Ponts et Chaussées) <[http://afitl.ish-lyon.cnrs.fr/tl\\_files/documents/vie-association/journee-doctorale/presentations2009/Jacques\\_Kembeu.pdf](http://afitl.ish-lyon.cnrs.fr/tl_files/documents/vie-association/journee-doctorale/presentations2009/Jacques_Kembeu.pdf)> accessed 08 January 2017.

<sup>36</sup> DSLV — Deutscher Speditions- und Logistikverband e.V. (German Association for freight forwarding and logistics), ‘General terms and conditions of logistics-services providers’<<http://www.jcl-logistics.com/assets/PDF/AGB/LogistikAGBenglisch.pdf>> accessed 08 January 2017

<sup>37</sup> Forslund H.: ‘Logistics service performance contracts: design, contents and effects’, (School of Management and Economics, Växjö University, Växjö, Sweden, Emerald 2008); Ramber J., ‘The Future of Transport operators and Service Providers’, (Heinonline, 46 Scandinavian Stud. L. 135 2004); Olander M. and Norrman A.: ‘Legal analysis of a contract for advanced logistics services’, (Lund University, Lund, Sweden, Emerald 2012).

<sup>38</sup> INALOG: <<http://www.inalog.org.uy/>> accessed 08 January 2017.



These are *modalities* of LCs and not contracts themselves when considering logistics operations.

Additionally, the LC should not be considered as a mere juxtaposition of logistics services; on the contrary it should be deemed as a really precise commercial contract which efficiently connects different services in a logistic way in order to make the supply chain work properly according to the needs of the cargo owner.

What is intended to be established is the nature of the LC and the analysis of *the specificity of its object* can help to determine it. As mentioned previously, there is a large variety of services that could be included under a LC: *carriage of goods, warehousing, material handling (Picking, etc.), inventory, packaging* and often *security*.

The real possibility of adapting the main object of the contract while the contract conserves its own identity as LC; and more important, the fact that there are different services of a logistics nature which efficiently connect logistics services considering not only taking goods from “A” to “B” as the traditional models suggested, but also doing so in conformity with a certain schedule and with the particular rhythm of the cargo owner’s business, is what distinguishes this contract and renders it unique.

Regarding liability issues that may arise when the LC is tried to be adapted to carriage of goods or warehousing regulations, (among others) the extended liability of the LO over the goods seems to deserve a revision.

At a descriptive stage, it is possible to assess that transportation liability rules and warehousing ones are not the same. They are directed to different contexts so the problems and solutions that may arise are distinctive.

The problem arises when the role of LO is defined as someone with real expertise on logistics who is going to carry, store and handle the goods.

It is at this point that it can be affirmed that the liability in LOs is extended. When providing transportation services, liability will not be terminated when the goods are delivered as is the case in a carriage of goods contract. This is because of the fact that it is the same LO who is formally taking the goods when the transportation service is over.

The same happens when analysing the storage of the goods stage by a LO. Once the storage service is completed, the goods may be taken by the same LO who acted as warehouse man but who will be also acting as carrier.

However, if a situation is considered in which the obligation and liability of the LO is still active until the delivery of the goods is finalised — in regard to delivery for final consumption (even when other logistics services have been provided in between) the LO will be still liable for the goods but under the terms of the carriage of goods contract. So, what about any issue arising during the storage of the goods? In this case, strict liability (English law) under the contract of carriage of goods could be applied to the LO but it might not present a fair solution. Especially since among different regulations, the duties of the warehouseman are not usually deemed as an “obligation of result<sup>39</sup>” (applied on Civil Law jurisdictions. But even when this concept is not usually applied under common law legal systems, “strict liability” sets up similar consequences).

And what about those cases in which there is a regular supply chain provided by the LO to the cargo owner in which certain goods are taken by the LO, carried, stored, carried to another smaller warehouse and regularly part of these goods are delivered to final destinations for final consumption? This is usually the case of fast moving consuming goods (FMCG) owners who completely outsource their supply chain services. Should the first delivery of only a part of the goods be deemed as partial delivery or as a final one?

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<sup>39</sup> Result obligation: obligations to deliver a certain result.

In the last case, how should the liability be assessed in regard to those goods still stored under the control of the same LO? The duties of the LO should be deemed already covered? Even when a contract can consider several factual situations, the current regulation is not giving precise solutions to this kind of questioning since the LC is still tied to outdated models of law: mainly the traditional contracts of carriage and warehousing.

As mentioned previously, when researching different local regulations, no references related to the issue of liability of LOs could be found. Not even the word *logistics* is usually mentioned among their rulings. Most of the local legal frameworks just directed their efforts solely to transportation and warehousing services.

Nonetheless, within the international legal framework, as already discussed, the attempt of the *Rotterdam Rules (2009)* seems to be an interesting approach as some logistics services were considered within its content.

One example is the definition of “inland carrier” in art. 1.7 already provided by which the following definition of “Maritime performing party” is stated: “*A performing party to the extent that it performs or undertakes to perform any of the carrier’s obligations during the period between the arrival of the goods at the port of loading of a ship and their departure from the port of discharge of a ship. An inland carrier is a maritime performing party only if it performs or undertakes to perform its services exclusively within a port area*”.

Therefore, the inland carrier will be someone who is providing services within the port terminal such as: *warehousing and general handling of the goods*; similar to the idea of a LO.

Additionally, this convention also presents an original feature regarding the previous conventions such as the Hamburg Rules<sup>40</sup> in regard to the period of liability of the carrier. Art 12.1 of Rotterdam Rules states: “*The period of responsibility of the carrier for the goods under this Convention begins when the carrier or a performing party receives the goods for carriage and ends when the goods are delivered*”

Moreover, in art. 13.1, it states that: “*The carrier shall during the period of its responsibility ... properly and carefully receive, load, handle, stow, carry, keep, care for, unload and deliver the goods.*”

The terms “*keep*” and “*care for*” can allow thinking about a *warehousing service* provided by the “*carrier*” under the convention but it is necessary to bear in mind that the intention of the article is to examine the obligations of the “*carrier*” as defined in art. 1.5<sup>41</sup> and even when storage is considered there is the limitation of art. 1.7 which has already been discussed.

This is an interesting approach to the idea of LOs considering the way logistics services are performed nowadays, but it is quite limited since the Rotterdam Rules do not consider the full logistic service that a LO is actually providing to cargo owners. Indeed the scope of the convention would be the main limit since it is aimed at *International Carriage of Goods (Wholly or Partly by Sea)*.

## Conclusion

The specificity of the object of the LC, as was indicated in chapter 3 represents an essential particular element of this contract considering the multiple possible scopes it can encompass while keeping the same legal identity.

The fact that logistics services are no longer considered as merely moving goods from “A” to “B” as was regarded by the traditional conception, but as to consider the transportation and the storage of goods

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<sup>40</sup> Hamburg Rules Art. 4.1: “*The responsibility of the carrier for the goods under this Convention covers the period during which the carrier is in charge of the goods at the port of loading, during the carriage and at the port of discharge*”.

<sup>41</sup> Rotterdam Rules Art. 1.5: “*Carrier means a person that enters into a contract of carriage with a shipper*”.

within a certain timeframe and according to very specific and detailed instructions from the cargo owner, makes the LC a comprehensive legal concept different from the mere transportation or warehousing contracts.

Notwithstanding this contractual uniqueness and the fast path growth of logistics activities in the past few decades, local and international regulations still seem to be reluctant to give the treatment LCs might deserve. Legal issues related with the liability of the LO seem to be one of the weakest points of most of the current legal frameworks ruling over commercial relations under a LC.

Despite of the unwillingness of legislators to acknowledge the growing importance of LC, as the supply chain approach has been shaped by the perspective of big cargo owners, the implementation of new logistics models gave the LC an extraordinary impulse to get a tacit and indirect recognition<sup>42</sup> which cannot be denied nowadays.

Furthermore, as described in chapter 2, in most of the analysed jurisdictions, the current applicable regulations seem to be unfit for logistics processes and particularly dispersed. This is usually deemed as an obstacle for predictability for the contracting parties. The applicable legal framework will be determined considering the scope of each LC. Thus there seems to be an additional barrier for the LO and cargo owner.

Moreover, while this recognition still depends on the legislator, legal practitioners and contracting parties have moved forward negotiating and agreeing on terms usually based on the guidelines provided by Standard Terms for LCs (Logistics chambers).

An additional unexplored area regarding the functioning of the LC is the “qualification” of the LO by the inscription on public registries which should be developed as further research.

The reasoning behind this suggestion is that as nowadays logistics services are a key aspect of every economic structure, it should not be provided by any person or company just because they are able to offer or do so. The services offered under LC are (or should be) performed by highly qualified LOs with real expertise in the logistics field. Even when intermediary parties are the ones actually performing the services, the LO is usually acts as principal and fully assumes liability under most local and international regulations. Hence, the inscription would be deemed as a guarantee of transparency of information for cargo owners applicable to all contracts (or only to those contracts dealing with certain goods when Public Policy reasons arise,) since an authority would be supervising and approving this “qualification”.

The intention of this work highlighted the existence and nature of the LC considering the relevant role of logistics within every economic system. Therefore, various elements allow defending the categorization of LCs as *Sui Generis*.<sup>43</sup>

As the LC came to stand out as the *de facto* main contractual way to agree on terms for national and international logistics, legal provisions based on old concepts and business structures such as traditional contracts of carriage or warehousing are likely to become outdated.

Regardless of that, some legal modifications might be expected for the medium and long-term within some EU jurisdictions and the international legal framework and UNCITRAL seems to have a key role in this task.

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<sup>42</sup> R. A Etcheverry, *Derecho Comercial y Económico, Obligaciones y Contratos Comerciales*, (Parte General, Astrea, Argentina pg. 114 et seq).

<sup>43</sup> Oxford University Press — Oxford Dictionary, ‘Sui Generis’ definition: “*Different of all other...things*” <<http://www.oxfordlearnersdictionaries.com/definition/english/sui-generis>> accessed 30 July 2016.

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*Rules for Electronic Platforms:  
The Role of Platforms and Intermediaries in Digital Economy  
A Case for Harmonization*

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*I. From Transaction-Oriented Rules to Platform-Focused Regulation: A Case for a Change of Approach*

In its infancy, the irruption of digital technology did clearly start impacting on the contracting process and transforming transaction components (writing, signature, original, message, methods for the manifestation of consent, sending and reception of electronic communications). The real challenge posed by digital technology at its early stage was to assess which adaptations of existing legal concepts were needed and/or which new rules were required by the use of electronic communications and digital medium in the negotiation, the formation and the performance of contracts. The pioneering UNCITRAL texts on electronic commerce did perfectly understand such needs and flawlessly address them first in the Model Laws — UNCITRAL Model Law on Electronic Commerce, 1996; UNCITRAL Model Law on Electronic Signatures, 2001 — and subsequently in the Convention — United Nations Convention on the Use of Electronic Communications in International Contracts, 2005 -. Within the framework demarcated mainly by the principles of functional equivalence and technological neutrality, these international texts set out the legal equivalences for paper-based institutions and provide for the basic rules to ensure the legal recognition of the use of electronic communications in (international) contracts.

UNCITRAL Model Laws first and UN Convention afterwards enshrined the fundamental principles of electronic commerce law and inspired regional initiatives and a number of domestic legislations. Today, it can be firmly affirmed that a legal framework for electronic contracting has been consolidated.

Nevertheless, the accelerated evolution of digital economy has shown that digital technology is not only transforming contractual process and transaction components — as the use of electronic commerce in the formation and the performance of contracts reveals — but it is also reshaping structures and organizations and even creating new environments for business activities, social relationships, education, entertainment, public services or cultural initiatives. The most conspicuous manifestation of such a transformative power is the pervasive expansion of electronic platforms. Certainly, digital economy is today a platform economy. Electronic platforms are the dominant organizational model<sup>1</sup> for business activities, social networks, emerging businesses, public environments or educational systems in today digital society.<sup>2</sup> Remarkably, the emergence and increasing popularity of disruptive models, such as sharing-based economy, crowdfunding or fintech variants, have not only been made possible but greatly stimulated by the platform-based organizational solution.

Rules adopted by UNCITRAL instruments, and their adaptations in domestic and regional texts, did successfully deal with and resolve digital challenges related to the use of electronic means and digital medium (electronic communications) in the formation and the performance of contracts. These existing rules are clearly transaction-oriented. They conceive the transaction as the relevant unit for regulation purposes and they build up the rules on the electronic communication as the minimum denominator of electronic contracting situations. Such problems, rules and solutions represent the first generation of electronic commerce. Legal concerns aroused by electronic platforms usher into the second generation of electronic commerce.

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<sup>1</sup> MALONE, Thomas W., “Modelling Coordination in Organizations and Markets”, *Management Science*, vol. 33, num. 10, October 1987, pp. 1317-1332; MALONE, Thomas W.; YATES, JoAnne, BENJAMIN, Robert I., “Electronic Markets and Electronic Hierarchies”, *Communications of the ACM*, (30:6), June 1987, pp. 484-497.

<sup>2</sup> A thorough legal and business analysis of electronic platforms (e-marketplaces) in RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *El régimen jurídico de los Mercados Electrónicos Cerrados (e-marketplaces)*, Madrid: Marcial Pons, 2006.

So as existing rules are essentially transaction-oriented, a platform economy claims an organization-oriented legal approach. As further explained below, the entering the digital scene of electronic platforms poses questions, from a legal perspective, on two fascinating angles: how platforms work and which role platforms, or more precisely platform operators,<sup>3</sup> do or should perform in digital economy. This shift from a transaction-oriented approach to an organization-oriented one is not a mere change of scale or focus. The emergence of platforms in digital economy arouses a number of appealing issues that are new and different and go beyond the effect of using electronic communication in the formation and the performance of contracts. First, a category of legal issues associated with the fact that platforms become self-regulated environment on contractual basis, the extent of such a regulatory autonomy and its implications. Second, another category of legal issues arising from the trust-generating capacity of platforms (providing mechanisms to control access, supervision systems to monitor compliance, infringements and penalties policies, feedback reputational systems, rating techniques, dispute resolution models). Third, a category of relevant legal issues regarding the role of platform operators as regulators, supervisors, ‘first-line’ enforcers, and service providers, that lead to the debate whether platform operators act as genuine intermediaries and to which extent intermediary liability rules are then applicable.

Electronic platforms, however, have not received at all an all-embracing attention from a legislative point of view. Therefore, a legal framework for electronic platforms has not been developed. On the contrary, attention to electronic platforms has been, and is still, fragmented, partial and tangential. On the one hand, some jurisdictions have addressed liability exposure of electronic intermediaries and devised a specific legal liability regime in form of ‘safe-harbour’ scheme — remarkably, US Section 512 *Digital Millennium Copyright Act*, EU *Directive on Electronic Commerce* and its incorporation in domestic legal system by Member States -. But it is questionable whether platform operators are genuine intermediaries for the purposes of the specific liability regime. Therefore, rules on intermediaries do not fully cover all legal angles of platforms. On the other hand, some specific rules have been adopted in relation to sectorial platforms such as regulations on crowdfunding platforms<sup>4</sup> or Alternative Trading Systems<sup>5</sup>/Multilateral Negotiating Systems or Facilities.<sup>6</sup> Given their sectorial scope, these rules do not embrace platforms as a

<sup>3</sup> KANNAN, P KANNAN, P.K., CHANG, Ai-Mei; WHISTON, Andrew B., “The Internet Information Market: The Emerging Role of Intermediaries”, in SHAW, Michael J.; BLANNING, Robert W.; STRADER, Troy J.; WHINSTON, Andrew B., (Ed.), *Handbook on Electronic Commerce*, Heidelberg: Springer, 2000, pp. 569-590.

<sup>4</sup> Austrian Federal Act on alternative means of financing (Alternative Financing Act-*Alternativfinanzierungsgesetz, AltFG*) — Obligations for issuing bodies as well as operators of internet platforms (“crowdfunding”) regarding the financing of terrorism (sec. 4, para. 5 and sec. 5 para. 1 (2)), Federal Law Gazette Vol. I No. 114/2015; French *Décret n° 2014-1053 du 16 septembre 2014 relatif au financement participatif*, JORF n°0215 du 17 septembre 2014 page 15228 texte n° 11; German Small Investor Protection Act, *Kleinanlegerschutzgesetz, Bundesgesetzblatt Teil I*, 2015, Nr. 28 vom 09.07.2015; Italian Regolamento sulla raccolta di capitali di rischio da parte di start-up innovative tramite portali on-line. Delibera num. 18592, and the attached Regulation of 26 June 2013, published in Gazzetta Ufficiale num. 162 dated 12 July 2013; Portuguese Lei n.º 102/2015 de 24 de agosto, *Regime jurídico do financiamento colaborativo*, *Diário da República*, 1.ª série — N.º 164 — 24 August 2015; Spanish Business Finance Promotion Act, number 5 of 2015, *Ley 5/2015 de Fomento de la Financiación Empresarial*, as published in the Official Bulletin (BOE) 101 of 28 April 2015 (LFFE 2015); United States Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012, Pub. L. 112-106, Title III, 126 Stat. 318 (US Crowdfunding Act).

<sup>5</sup> MACEY, Jonathan R.; O’HARA, Maureen, “Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective”, *J.Legal Stud.*, vol. 28, January 1999, pp. 17-54; McCARROLL, Elizabeth M., “Regulation of Electronic Communications Networks: An Examination of TradePoint Financial Networks’ SEC Approval to Become the First Non-American Exchange to Operate in the United States”, 33 *Cornell Int’l L.J.*, 2000, pp. 211-262; MACEY, Jonathan; KANDA, Hideki, “The Stock Exchange as a Firm: the emergence of close substitutes for the New York and Tokyo Stock Exchanges”, 75 *Cornell L.Rev.*, 1989-1990, pp. 1007-1052.

<sup>6</sup> For instance, in European Union, Art.4(15) MiFID defines ‘Multilateral trading facility (MTF)’ as ‘a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments — in the system and in accordance with non-discretionary rules — in a way that results in a contract in accordance with the provisions of Title II’. Today, relevant rules in MiFID II and MiFIR — *Directive (EU) 2016/1034 of the European Parliament and of the Council of 23 June 2016 amending Directive 2014/65/EU on markets in financial instruments* (Text with EEA relevance), OJ L 175, 30.6.2016, p. 8-11; *Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and*



whole either. The legislative response to platforms is still partial and limited to certain jurisdictions, fragmentary in an international context, and to that extent non-uniform.

The convenience of adopting specific rules on platforms at a general level is at present being considered by the European Union,<sup>7</sup> China, and other domestic jurisdictions to update, modernize or simply expand the scope of their electronic commerce laws. Such a multiplicity of regulatory initiatives, likely to lead to diverging outcomes, is not consistent with the natural transnationality, or more precisely a-nationality, of activities within electronic platforms. More importantly, a multi-jurisdiction regulatory approach is frontally colliding with the rationale behind the emergence of electronic platforms: to create self-regulated environments, to the maximum possible extent, self-sufficient and disassociated from domestic jurisdictions.

As global digital economy is growing on the basis of platform-based models, disparities in approach, or in regulation raise obstacles to international trade, arouse uncertainties, increase risks in electronic commerce transactions conducted, indeed, through electronic platforms, and asphyxiate the flourishing of innovative and disruptive business models. In absence of a harmonized framework for electronic platforms, case law and legal rules at domestic/regional level differ. As a consequence, not only cross-border activity and electronic transactions are discouraged, but, above all, efficiencies deriving from and opportunities associated to the resort to electronic platforms are missed and the trust-creating potential of electronic platforms is seriously undermined.

The aim of this Paper is first to explain how the digital economy, as a platform economy, needs the refocusing of rules on electronic commerce from a transaction-oriented approach to a platform-focused regulation, and advocate that such rules on electronic platforms should be uniform, international and the result of a harmonizing process. Electronic platforms are a key element in the trust-creating policies for digital economy. A common legal framework for platforms would infuse more predictability in digital activities, reduce the likeliness of jurisdiction arbitrage, catalyse the development of emerging models, and better prepare international legal system for the coming of new disruptive technologies (block chain, distributed ledger). The second aim of this Paper is to briefly venture possible issues that should most likely be covered within a future uniform legal framework for electronic platforms.

Considering the above-mentioned aims, the Paper is structured as follows. Part II describes how platforms operate and separates platforms into their personal and relational components to construct a legal concept. Part III focuses on the role of platform operators and the implications in terms of liability exposure. Part IV summarizes possible angles of a regulation on electronic platforms.

## II. *Inside a Platform: A Legal Look*

Electronic platforms, in all their variants (e-marketplaces, sharing-based platforms, business communities, social networks, crowdfunding platforms) are and operate as closed electronic environments. The closure of an environment does not depend on a specific technology, the use of certain communication technique or the level of security that may indeed be high as well in opened environment. The difference between an open environment and a closed one is essentially based on a legal factor. As further explained below, the closing of an environment is achieved by the use of a contractual infrastructure that create a contract-based trustworthy context for the users, self-contained, self-regulated, and, to the maximum possible extent, independent from domestic jurisdictions. Hence, an electronic platform, as a closed environment, is built by a set of agreements between the operator and the users' community. In absence of specific legal rules, obligations and rights of platform operators are laid down by the contract terms between

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*on central securities depositories* (Text with EEA relevance), OJ L 175, 30.6.2016, p. 1-7.

<sup>7</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *Online Platforms and the Digital Single Market Opportunities and Challenges for Europe*, SWD(2016) 172 final, COM(2016) 288 final Brussels, 25.5.2016. MAXWELL, Winston & PÉNARD, Thierry, *Regulating digital platforms in Europe — a white paper*, December 2015, at [www.digitaleurope.org](http://www.digitaleurope.org) (last visit, 14/2/2017).

the operator and every user, and, consequently, the role to be actually performed by operators is devised by the set of contracts supporting the platform.

The ultimate aim of a closed environment is in fact to generate trust in an uncertain playing field. Trust means predictability, reduction of uncertainties, and minimization of risks. Electronic platforms have pervaded the digital economy on the grounds of an efficiency hypothesis — “Electronic Markets Hypothesis” (MALONES, YATES & BENJAMIN) —: cost reduction, transparency enhancement, integration and syndication opportunities<sup>8</sup> and trust generation.

### *II.1. Building a Platform: Parties and Contractual Relationships in an Electronic Platform*

Platforms are multi-party organizational models organized in two layers. On the one hand, the platform operator who manages the platform. On the other hand, the community of users. These are indeed the two vectors explaining why the existing transaction-oriented approach is neither sufficient nor adequate. Precisely, platform-oriented rules should acknowledge and duly deal with the complexity of the structure, the plurality of users, the sense of community, and the relevant roles of the operator in regulating, supervising, enforcing and generating trust within the platform.

#### *II.1.A) The Platform Operator*

Electronic platforms are self-regulated communities managed by a platform operator. Despite that some functions can be designed and implemented to operate on a decentralized basis, as further explained below, electronic platforms are essentially centralized structures. The role of the platform operator is crucial to create and maintain a predictable, reliable and trustworthy playing field. The scope and the extent of operator’s functions are determined in each case by the membership agreement. When joining the platform, every user enters into an agreement with the operator. It is the membership agreement. Subsequently, registered users negotiate and conclude contracts among them according to the internal policies (platform rules).

Rarely, the operator is an individual (sole trader) or natural person. More usually, the operator adopts any of the organizational forms, available in the jurisdiction where it is located, to run a business (corporations, incorporate joint-ventures, private companies, but also associations, cooperatives or partnerships). Interestingly, those organizational forms entailing a distinct and separate legal personality are preferred. Likewise, commercial companies and corporations are the most widespread option.

Platform’s users can anyhow participate in the operator as members or managers. There is no legal reason questioning that. Nevertheless, some concerns on the neutrality of the operator and its ability to perform its functions on an independent basis may arise. As a matter of fact, should some (or all) users become members of the operator (partners or shareholders), the neutrality of its decisions as a regulator or as a supervisor in relation to the same users may be questioned and its attractiveness in the market may be debilitated accordingly. Therefore, the composition of the operator has to be very carefully considered.

In managing the platform, the operator provides added-value services, adopts rules, monitors compliance and penalizes infringements of internal rules by users. In sum, the operator acts as a service provider, a (contractual) regulator, and a (contractual) supervisor. Whereas the provision of services (payment management, insurance, inspection, rating, marketing) has a visible commercial impact, increasing the appeal of the offer in the market, fostering loyalty of users, and providing additional financial support; the tasks of regulating and supervising are key for the creation and preservation of trust.

A). Provision of services. Beyond basic services supporting the electronic trading infrastructure (*software*, security measures, information exchange), the operator may enhance the commercial appeal

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<sup>8</sup> BICHLER, Martin, *The Future of e-Markets. Multidimensional Market Mechanisms*, Cambridge: Cambridge University Press, 2001; SCULLEY, Arthur B., WOODS, W. William A., B2B exchanges. *The Killer Application in the Business-to-Business Internet Revolution*, New York: Harper Business, 2001; VOLLEBREGT, Erik, “E-Hubs, syndication and competition concerns”, 21 *ECLR*, issue 10, October 2000, pp. 437-443.

of the platform by providing a varied range of added-value services: payment services, rating, insurance, certification, inspection, or logistic services. The provision of added-value services tends to increase users' loyalty (raising switching costs), impede full substitutability with competing offer, and favour integration.<sup>9</sup>

B). Adoption of Platform Rules (Rulesbook). Electronic platform are self-regulated environments. As per the membership agreement, the operator is entitled to adopt rules in form of eligibility requirements to access the platform, codes of conduct, negotiation standards, model contracts, performance conditions, infringements and penalties policies. By accepting the membership agreement, each user takes the commitment to comply with in-force market rules and internal policies. Accordingly, whether the user fails to act in accordance to market rules and policies, the operator is entitled to claim default remedies.

C). Supervision and monitoring: Infringement and Penalties Policy. As per the membership agreement, the operator is entitled (has the right not the obligation) to monitor and supervise the compliance of rules and policies by users and take reasonable measures accordingly. In practice, supervision model is frequently based on a decentralized report system where users notify the operator any infringements committed by other users (report systems and notice and takedown systems in line with the mechanisms implemented to articulate 'actual knowledge' under the 'safe-harbour' regime for intermediaries).

### *II.1.B). The Users: Building a Community*

The broad term of "users" describes all registered members of the platform irrespective of their position (buyer/seller, lessor/lessee, licensor/licensee, investor/promoter, driver/passenger) they may hold in the subsequent transactions to be concluded or the relations or interactions of any nature entered into within the platform.

From a legal viewpoint,<sup>10</sup> every user is the counterpart of the platform operator in the membership agreement and, at the same time, a prospective contracting party in future market transactions in relation to other users. From a technical perspective, upon registration, users are entitled to access the platform, use the functionalities and be beneficiary of services in conformity with their user profile. In practice, by logging with the activated key (password, username, electronic signature), the user is enabled to exercise rights and enjoy services in accordance to the contractual framework (membership agreement and service provision agreements). User account keys serve as contract-based electronic signatures for the purposes of any action to carry out within the electronic platform. It is commonplace that the own platform operator acts to that end as a certification agency issuing the keys, monitoring the use and managing cancellation, expiration and any further circumstances likely to affect the validity of the contractual electronic signature. Nevertheless, the issuance and the monitoring of the electronic signature could also be entrusted to a third certification agency. In the latter case, the function of controlling user access would be, at least partially, outsourced.

Upon admission, registered users join the business community, strongly agglomerated and compacted by the common compliance of platform policies (internal protocols, rulesbook, codes of conduct, market rules).

Depending on the structure of the market, users can be admitted in the platform to operate solely in one of the prospective contracting position (as the vendor, as the licensor, as the lessor) or in both of them (either vendor or buyer, licensor or licensee, lessor or lessee). In some sectors, should the scope of the

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<sup>9</sup> BAKOS, Yannis; BRYNJOLFSSON, Erik, "Organizational Partnerships and the virtual corporation" in *Information Technology and Industrial Competitiveness: How Information Technology Shapes Competition*, London: Kluwer Academic Publishers, 1997, Chapter 4.

<sup>10</sup> In detail, RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *El régimen jurídico de los Mercados Electrónicos...*, *op.cit.*

platform only cover one stage of the production/distribution chain, users are normally expected to operate in the same contracting position in all transactions — i.e. providers of spare parts, on the one hand, and manufacturers, on the other -. Accordingly, two different membership agreements should be drafted to sign in accordance to the expected contracting position (i.e. a membership agreement model for sellers and a membership agreement model for buyers).

As regards the relationship between the operator and the users, it might be well worth discussing the possibility for users to be members of the operator or to anyhow participate in the operator's decision-making and the legal consequences likely to derive therefrom. The market of markets offers a wide variety of models<sup>11</sup> as regards the ownership structure: independent markets, non-independent markets and mixed markets. Interestingly, ownership structure is not only an element contributory to the design of the business strategy, but also represents one of the decisive factors in the assessment of competitive concerns and in the devising of effective and reliable regulatory/supervisory models.

(i) Independent or neutral markets (*neutromediaries*). Under an independent model in terms of ownership, the management role in the platform is played by a company (or entity) independent from market participants. Accordingly, platform users cannot participate or have any interest in the operator (i.e. as shareholders). Overall, such a neutrality feature alleviates competition concerns and seemingly fortifies the reliability of a centralized regulatory/supervisory model.

(ii) Non-independent markets (*consortium* or *coalition markets*). Under this category, market participants (users) are members of the operating company, participate in the decision-making process, carry out management tasks or anyhow control the operator. Users may hold majority of the operator or simply represent a minority group. Likewise, all users or solely a few of them meeting certain conditions might be eligible to participate in the operator. As a consequence, non-independent markets can be further classified as supply-biased markets, demand-biased markets or hybrid markets depending on the commercial position held by the users who are entitled to participate.

From a business point of view, the economic rationale behind non-independent markets is rather patent. Non-independent models are industry-sponsored marketplaces. Hence, industry features and specific market interests are widely considered in the design of the platform and effectively internalized in market policies.

From an economic perspective, according to the scientific literature<sup>12</sup> it can be argued that electronic marketplaces favour buyers to the extent that reduce vendors' market power.<sup>13</sup> As a matter of fact, electronic markets would enhance information distribution and increase price competition. As a consequence, market equilibrium would be rebalanced in favour to buyers. As per such an economic rationale, buyers should arguably be more inclined to promote the creation of electronic platforms. Contrarily, a quick market observation reveals that there are platforms promoted by sellers (*offer-biased markets*). Very simply, expected profits earned as a platform operator could compensate the loss in purchase price as sellers.

Nevertheless, and despite the above-mentioned strategic reasons, non-independent markets arouse several legal concerns though. Remarkably, competition issues are likely to arise in the creation of non-independent markets involving leading companies in the relevant sector.<sup>14</sup>

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<sup>11</sup> A wider classification according to a selection of criteria in RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *El régimen jurídico de los Mercados Electrónicos...*, op.cit, Chapter 2.

<sup>12</sup> BAKOS, J. Yannis, "Reducing Buyer Search Costs: Implications for Electronic Marketplaces", *Management Science*, vol. 43, num. 12, December 1997; STIGLITZ, Joseph E., "Imperfect Information in the Product Market", en SCHMALENSEE, Richard; WILLIG Robert D., (ed.), *Handbook of Industrial Organization*, New York: North-Holland, 1989, pp. 769-847.

<sup>13</sup> YOO, Byungjoon; CHOUDHARY, Vidyanand, MUKHOPADHYAY, Tridas, "Pricing Strategies of Electronic B2B Marketplaces with Two-Sided Networks Externalities", *Proceedings of the 35th Hawai International Conference on Systems Sciences*, 2002.

<sup>14</sup> *Covisint* case (IP/01/1155) (38.064) or *Volbroker* case (IP/00/896) (38.866) -.

(iii) Mixed markets. In these markets, both sector participants and independent players are members of the platform operator. Synergies between, on the one hand, the neutrality perception favoured by independent markets and, on the other hand, the closeness to the market and the sensitivity to sector interests permitted by non-independent markets are triggered. Independent players are usually investors or technology suppliers.<sup>15</sup>

### *II.1.C). The Membership Agreement*

The membership agreement is concluded between the platform operator and each of the users meeting the eligibility requirements and successfully admitted in the platform.<sup>16</sup>

Schematically, the membership agreement has the following features:

- (i) It is concluded electronically.
- (ii) It may be a B2B or a B2C contract that is then subject to consumer law.
- (iii) Although it is not fitting into a typified contractual model, it reasonably qualifies for being deemed a service provision contract with mixed obligations.
- (iv) It is a standard term contract. Terms are pre-drafted by the operator and apply to all membership agreements of the same category (vendors, buyers, licensors, licensees). In general, the user is unable to negotiate, does not participate in the drafting and has to adhere to the contract on a “take-it-or-leave-it” basis.

Even if the membership agreement aims to regulate the relationship between the platform operator and each user, its performance casts over the whole community, its terms deal with interaction among users and it contains obligations on the user and the operator to be exerted in relation to other users. In sum, the membership agreement is the main building material to pile up and flatten the community ground. Interestingly, by virtue of the agreement, each user commits to comply with in-force internal policies and market rules not only in interacting and dealing with other users. Therefore, in case of breach of rules, the operator is entitled to resort to available remedies on grounds of breach of contract and, likewise, injured users can ask the operator to adopt agreed measures against the infringing user (according to infringements and penalties policy) or claim compensation from the operator on grounds of its default.

### *II.1.D). Self-Regulation in Practice: Internal Policies, Rulesbook and Codes of Conduct*

In exercising the role of regulator, the platform operator adopts rules of varied nature to govern the access, the use of services, the negotiation, conclusion and performance of transactions and the exchange information within the platform (internal policies, rulesbook, code of conducts).<sup>17</sup> As per the membership agreement, users are to abide by the market (platform) rules in force. The most widely adopted model is the centralized regulatory one. Under such a model, the operator is empowered by users to freely adopt, modify or amend rules to be in force in the platform. More exceptionally, however, users’ involvement in the regulatory process may be anyhow encouraged. Should community spirit want to be stimulated, a more

<sup>15</sup> In some deals notified to the European Commission for competition scrutiny, platform operators responded to such hybrid ownership schemes: *MyAircraft.com*. COMP/M.1969 *UTC/Honeywell/i2/MyAircraft.com*, 4.8.2000. IP/00/912; *Chempler*. COMP/M.2096 *BAYER/Deutsche Telekom/Infraserv/JV*, 6.10.2000, IP/00/1131; *ec4ec*. COMP/M.2172 *Babcock Borsig/MG Technologies/SAP Markets/JV*, 7.11.2000, IP/00/1266; *Governet*. COMP/M.2138, *SAP/Siemens/JV*, 2.10.2000, IP/00/1102; *Date AS by Telenor Bedrift AS, Den Norske Bank ASA, ErgoGroup AS and Accenture Technologies Venture BV* (IP/01/638).

<sup>16</sup> About the admission process and the implications of a refusal to deal, RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, “Refusal to Deal, Abuse of Rights and Competition Law in Electronic Markets and Digital Communities”, *European Review of Private Law*, vol. 22, 5-2014, pp. 685-702.

<sup>17</sup> RAMBERG, Christina, *Internet Marketplaces. The Law of Auctions and Exchanges On-line*, Oxford: Oxford University Press, 2002.

participatory model should be designed. If so, users would be informed, consulted or even called to vote in reform projects, amendments or enactment of new policies.

### III. *The Platform Operator as an Intermediary: The Theory of Reintermediation Cycle*

As far as the legal framework for the provision of online services is concerned, electronic platform operators can be deemed intermediary service providers (ISP) in relation to contents, activities and behaviours published, transmitted or performed by their users.

Accordingly, ‘safe harbour’ regime would be applicable to delimit their liability — articles 12-15 Directive on Electronic Commerce with direct antecedents in US legal model divided into the *Communications Decency Act* of 1996 included as Part V of *Telecommunications Act* (Pub. L. 104-104, 110 Stat. 56 (codified at 47 U.S.C. 230) and the *Digital Millennium Copyright Act*, Pub. L. No. 105-304, 112 Stat. 2860 (28 Oct. 1998) (codified at 17 U.S.C. 512) -. The European Court of Justice confirmed that assertion when expressly held in ECJ 12 Jul. 2011, C-324/09 *L’Oréal SA and Others v. eBay International AG and Others*, <http://curia.europa.eu/juris/liste.jsf?language=en&num=C-324/09>:

‘Article 14(1) of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on electronic commerce”) must be interpreted as applying to the operator of an online marketplace where that operator has not played an active role allowing it to have knowledge or control of the data stored’.

However, case law is not consolidated, decisions are not consistent, and, more importantly, concepts and rules are not uniform. When the operator is playing an active role?

Besides, electronic platforms are contract-based buildings. Such a contractual infrastructure designs the liability regime and indeed allocates duties and liabilities between operators and platform’s members. Since ‘safe harbour’ regime is based on lack of knowledge and lack of control, operators manage to preserve their position with a right (but not an obligation) to monitor and supervise so as to enhance confidence without exposing themselves to liability risks. To which extent are platform operators entitled to define their obligations (or rights) and delimit their liability exposure? Should their obligations be provided for by the law? Or should a specific liability regime be established instead?

According to economic theories on intermediation, electronic platforms’ operators clearly perform intermediaries’ typical functions. Traditionally, intermediaries aim to solve market failures. Information asymmetries aggravate failures in digital markets. Therefore, intermediaries take on the challenges to facilitate interaction, enable matching, reduce cost, diminish the number and the complexity of relationships (‘Baligh-Richartz effect’), and enhance confidence exploiting reputational factors to minimize opportunist behaviours and externalities.

The economic theory of intermediation contributes a functional perspective to the most formalist legal concept of intermediary service provider. From a harmonious combination, it is my belief<sup>18</sup> that a new understanding of electronic intermediation can be advocated. Far from the initial contention that digital technology would trigger an intense and definitive disintermediation process, a growing reintermediation process is actually explaining the state and the evolution of digital society instead. The intermediation cycle turns then from a disintermediation phase to an appealing reintermediation phase.<sup>19</sup>

<sup>18</sup> RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, “El tercero de confianza en el suministro de información. Propuesta de un modelo contractual para la sociedad de la información”, *Anuario de Derecho Civil*, Tomo LXIII, Fascículo III, 2010, pp. 1245-1284; and “Intermediación electrónica y generación de confianza en la Red: escenarios de riesgos y responsabilidad”, *Revista Española de Seguros*, núm. 153-154, 2013, pp. 43-68

<sup>19</sup> CHIRCU, Alina M.; KAUFFMAN, Robert J., “Strategies for Internet Middlemen in the Intermediation / Disintermediation / Reintermediation Cycle”, *Electronic Markets*, vol. 9, issue 2, 1999, pp. 109-117

Whereas disintermediation describes the removal of middlemen from processes, chains and markets, reintermediation entails not only the reversion of such a trend but also the emergence of new areas where intermediation creates value. The reintermediation process is then a complex and multi-faced phenomenon intended to mitigate failures, create value and satisfy social and business needs as presented in the digital environment. As far as electronic relationships are becoming more closely woven and products and services more sophisticated, intermediation needs have been evolving in the digital environment and intermediation profiles have redesigned and devised accordingly. Changes in the management and the structure of the distribution chain are probably rather evident and easily perceptible. Digital technology forces manufacturers and retailers to make innovations in distribution, such as shortening the channel, removing intermediate and unnecessary phases, approaching to clients, customizing strategies. Intermediaries have achieved to recover their roles in the chain, moving backwards and forwards along the distribution channel and learning to provide added-value services to users (recommender systems<sup>20</sup>, botshops, comparison tools). Notwithstanding the foregoing, it is our contention that the reintermediation wave overflows the case of electronic intermediation in the distribution channel to provide intermediation services in a range of significant areas, in an appealing process less perceptible but crucial for the functioning of the digital world.

#### *IV. Key Issues to Consider for a Platform-Oriented Regulation*

The above analysis of the structure and the operation of electronic platforms reveal three new legal angles to consider in a platform-oriented regulation, that are not sufficiently dealt with by transaction-oriented rules.

First, the two-layer structure of a platform (user layer and operator layer) requires to address the question of which obligations the operator may assume in relation to the users, the transactions conducted within the platform and/or other aspects related to the activity within the platform or of the platform itself in the platforms market (privacy<sup>21</sup>, IP rights, consumer rights protection, money laundering, misrepresentation, authentication, etc).

Such obligations can be accepted and configured by the terms of membership agreement between the operator and the users in exercise of and within the limits of the private autonomy; or they could be provided for by legal provisions that might prevent the parties from excluding or limiting such duties. To the extent that legal rules impose obligations on the operators, they do also define their possible roles in the digital economy as regulators, supervisors, ‘first-line enforcers’, gatekeepers<sup>22</sup> in different ways, and certainly trust creators.

Those jurisdictions that are exploring the formulation of rules on platforms tend to prescribe duties on platform operators regarding the control of users’ identification, transparency duties, compliance monitoring, duty to verify information, or even obligations concerning the performance. Local, fragmented, and differing domestic rules are deeply inconsistent with the global nature of digital economy and, besides, happen to be highly inadequate (even inoperative in many cases).

Second, liability rules for platform operators should be very carefully discussed. Whether operators are deemed as digital intermediaries, specific ‘safe harbour’ provisions would apply; but whether platform

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<sup>20</sup> RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, “Legal Aspects of Recommender Systems in the Web 2.0: Trust, Liability and Social Networking”, en PAZOS ARIAS, Jose; FERNÁNDEZ VILAS, Ana; DÍAZ REDONDO, Rebeca P. (Eds.), *Recommender Systems for the Social Web*, Series “Intelligent Systems Reference Library” vol. 32, New York (etc): Springer-Verlag, 2012, pp. 43-62.

<sup>21</sup> RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, “Legal framework for personalization-based business models”, in PAZOS-ARIAS, José J.; DELGADO KLOOS, Carlos; LÓPEZ NORES, Martín (Eds.), *Personalization of Interactive Multimedia Services: A Research and Development Perspective*, Nueva York: NOVA, 2009, pp. 3-24.

<sup>22</sup> CHOI, Stephen, “Market Lessons for Gatekeepers”, 92 *Nw.U.L.Rev.*, 1998, pp. 916-966; KRAAKMAN, Reinier H., “Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy”, 2 *J.L.Econ. & Org.*, n° 1, Spring 1986, pp. 53-104.

operators may configure their role by agreement, liability exposure is varied and depends upon the accepted degree of involvement and endorsement, if any.

At present, liability rules for intermediaries are not uniform and, more importantly, the debate about the falling of platform operators under the concept of intermediary for the purposes of the ‘safe harbour’ regime is opened and lacking of a consensus view. Even more, the implementation of mechanisms proving or presuming actual knowledge and the setting of factors revealing diligent/expeditious adoption of adequate measures by the intermediary upon awareness.

Thus, the formulation of a uniform concept of electronic intermediary, the adoption of a set of uniform criteria under which the platform operator might be deemed as an intermediary, and the devising of a common liability regime for intermediaries (actual knowledge, notice and takedown systems, adequate measures, supervision duties, etc) would be relevant areas to focus harmonizing attention.

Third, as the community-based architecture of platforms enable the articulation of decentralized trust-generating mechanisms (reputational feedback systems, recommender systems, rating and listing), it might be pertinent to consider the elaboration of uniform concepts regarding those decentralized reputational systems, reflect on possible common criteria in design and operation (good practices, standards), and clarify eventual liability scenarios.



## Session 5 — The credit economy

### *Can UNCITRAL Instruments Advance Supply Chain Finance to Benefit Small and Medium Enterprises?*

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#### *1. Introduction*

Supply chain management research has shown that a supply chain is as strong as its weakest link.<sup>1</sup> Often that weakest link is a small and medium enterprise (SME) from a developing country and it is starved for working capital.<sup>2</sup> This paper determines how some of the existing and upcoming UNCITRAL instruments can contribute to the advancement of supply chain finance (SCF)<sup>3</sup> programmes to benefit SMEs. In doing so the paper primarily focuses on the provisions of existing UNCITRAL instruments, namely, the draft Model Law on Electronic Transferable Records,<sup>4</sup> the Rotterdam Rules,<sup>5</sup> and the Model Law on Secured Transactions,<sup>6</sup> to analyse how flow of information connected to physical movement of goods can be extended to the associated financial flows in global supply chains. In this context, the paper also refers to the on-going efforts at Working Group I on micro, small and medium enterprises and the upcoming work of Working Group IV on cloud computing, identity management and trust services. The paper establishes that the red thread connecting various efforts of UNCITRAL can help to channelize dematerialised information to enhance visibility by allowing collaborative information sharing between stakeholders in global supply chains.

This paper argues that logistics service providers (LSPs) can allow greater visibility in the supply chain processes leading to lower level of inherent risk and allow financial institutions to deliver enhanced SCF programmes to SMEs.<sup>7</sup> Moreover, if SMEs are able to use dematerialised information, then financial institutions can extend SCF services throughout the supply chain.<sup>8</sup> Providing better access to finance to SMEs promotes sustainable development and fulfils Target # 8.3 of the United Nations Sustainable Development Goals.<sup>9</sup> The paper also critically evaluates the law making initiatives of UNCITRAL to show that greater institutional cooperation and usage of innovative governance techniques such as

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<sup>1</sup> Christopher, M., “Logistics and Supply Chain Management: Creating Value-Adding Networks”, 4th ed. Financial Times Prentice Hall, New York (2011).

<sup>2</sup> Y. Wang, “Online Supply Chain Finance: Profound changes in Financing of SMEs”, *Contemporary Logistics* 6, (2012).

<sup>3</sup> SCF is the inter-company optimization of financing as well as the integration of financing processes with customers, suppliers, and service providers in order to increase the value of all participating companies”. See Pfohl, H-C., Gomm, M., “Supply chain finance: optimizing financial flows in supply chains”, *Logistics Research*, 1(3)2009, pp. 149-161. This definition allows for a broad perspective in terms of the various actors that can benefit from different SCF programmes and highlights the need for coordination and integration throughout the entire supply chain. The definition is also practice-oriented in the sense that it focuses on “value creation for all participating companies”.

<sup>4</sup> Draft Model Law on Electronic Transferable Records with explanatory notes, A/CN.9/920 (4 January 2017) <https://documents-dds-ny.un.org/doc/UNDOC/GEN/V17/000/10/PDF/V1700010.pdf?OpenElement>

<sup>5</sup> United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea, United Nations Publication, Sales No. E.09.V.9, (2009) [http://www.uncitral.org/pdf/english/texts/transport/rotterdam\\_rules/Rotterdam-Rules-E.pdf](http://www.uncitral.org/pdf/english/texts/transport/rotterdam_rules/Rotterdam-Rules-E.pdf)

<sup>6</sup> UNCITRAL Model Law on Secured Transactions, United Nations publication, Sales No. E.09.V.12, (2016) [http://www.uncitral.org/pdf/english/texts/security/ML\\_ST\\_E\\_ebook.pdf](http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf)

<sup>7</sup> See section 5 of this paper for detailed discussion.

<sup>8</sup> See section 6 of this paper for detailed discussion.

<sup>9</sup> Target #8.3 enunciates to “promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services”, United Nations General Assembly, “Transforming Our World: The 2030 Agenda for Sustainable Development.” A/Res/70/1, 21 October 2015, [http://unctad.org/meetings/en/SessionalDocuments/ares70d1\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/ares70d1_en.pdf)

recourse/endorsement of private standards may be the way forward for improving trade regulation in the digital era.

## 2. *Need for SCF Programmes and the Emphasis on Information*

Twenty years ago, most international trade transactions used intermediated trade finance such as letters of credit, which not only supported the transaction by providing funds to the exporter or the importer or to both but also provided a sophisticated mechanism to mitigate the risks borne by exporters and importers. However, to speed up international trade transactions, in the past two decades trading parties have increasingly used open account, a form of inter-firm trade finance, which has exposed the exporter to non-payment risks.<sup>10</sup> Open account is cheaper than a letter of credit, but it does not offer the guarantee of payment from a financial intermediary. This left several exporters bankrupt during the financial crisis in 2007/2009 because the buyers to whom they had extended credit were insolvent.

Currently there exists a shortfall of 1.6 trillion USD in global trade finance.<sup>11</sup> Many multinational corporations (MNCs) have found that SME suppliers come under higher degree of financial stress because of their inability to raise working capital. Banks have shown reluctance to lend to SMEs because of the general economic environment and also due to new banking regulations such as Basel III standards that were introduced to boost bank capital, combined with stringent Know Your Customer (KYC) and Anti-Money Laundering (AML) compliance.<sup>12</sup>

While many governments have taken measures to support SMEs, the supply chain stakeholders have been innovating to harness information through digital technology platforms and digital market places to make finance more readily available to SMEs. For example, MNCs are participating in SCF programmes, often in conjunction with banks or other financial institutions, in order to help SME suppliers raise working capital. The invoices that the SME suppliers issue to the MNCs are transferred to a special purpose vehicle or trust, which is in turn funded by banks, institutional investors or, in some cases, the commercial paper market. These SCF transactions are often structured very similarly to a trade receivables transaction albeit with a key extra benefit for the investor or bank providing the financing, which is a direct payment obligation from the underlying debtor. Such financing structure take advantage of a number of legal mechanisms in order to achieve particular effects, but the cross-border nature often adds to the complexity, with multiple legal systems needing to be taken into consideration. Also, MNCs are combining processes of trade finance and cash management to link the financial supply chain with their internal physical supply chain processes of the company. Be that as it may, the SCF programmes initiated by MNCs are limited to certain parts of the supply chain.

Another example of private innovation is an intermediated trade finance solution offered by the banking industry since 2013, called the bank payment obligation (BPO). This trade finance form is in its nature very similar to a letter of credit, albeit not identical.<sup>13</sup> The BPO is a standardised interbank instrument, which is based on electronic information. Unlike a letter of credit, which requires that physical trade documents are manually examined, the BPO requires access to electronic trade data. This data is controlled, verified and matched over time in a highly automated process, as new electronic trade data are submitted about progress of the underlying trade transaction. However, BPO has not been successful so far. The primary barrier in the adoption of BPO is that it requires substantial investment both by banks and adopting companies. In its present form BPO is also restricted to a small part of the supply chain as it is mainly used by MNCs and large publicly rated companies. It fails to cater to the need of the SMEs.<sup>14</sup>

<sup>10</sup> See Love, I. Role of Trade Finance, Chapter 13 in Gerard Caprio (ed.), *The Evidence and Impact of Financial Globalization*, Academic Press: 1 edition (2012).

<sup>11</sup> Di Caprio, A., Beck, S., Yao, Y., Khan, F., “Trade Finance Gaps, Growth and Jobs Survey”, ADB Briefs No. 64, August 2016, p. 1, <https://www.adb.org/sites/default/files/publication/190631/trade-finance-gaps.pdf>

<sup>12</sup> *Ibid.*, 2.

<sup>13</sup> Wynne, G. L. and Fearn, H.: “The bank payment obligation: will it replace the traditional letter of credit — now, or ever?” (2014) *Butterworths Journal of International Banking and Financial Law* 102-104.

<sup>14</sup> Only 50 corporates and 20 banks can use BPO. See Dab, S., Ramachandran, S., Chandna, R., Hanspal, R., Grealish, A. and Peeters, M., “Embracing Digital in Trade Finance”, Boston Consulting Group, October 2015, p.

Based on the above examples, the question that arises is — how can the benefits of SCF be fostered across the entire supply chain? The answer lies mainly in managing information flows and creating security interests.<sup>15</sup> This is because electronic platforms are used to provide real-time transparency of physical and financial flows in various SCF solutions. Cross-border information flows have recently caught the attention of both international and national policymakers. In addition to efforts at UNCITRAL, several international institutions such as UN/ESCAP, UN/CEFACT, UNCTAD, WCO and WTO are currently working on various aspects of information flows to facilitate trade. Also, many national jurisdictions have promulgated cross-border data transfer regulations to prevent data from leaving the nation's borders to protect citizens' data from foreign surveillance, and also to protect personal data privacy and data security.<sup>16</sup>

### 3. *Financing of Receivables: Example of some SCF Programmes*

The journey of collateral available to businesses has moved progressively from immovable property (land) to movable property (goods and machinery), and subsequently, from tangibles to intangibles (invoices). Some of the popular SCF programmes involve monetization of the supplier's trade account invoices that are known as receivables. Earlier, there were predominantly two types of receivables financing: factoring and invoice discounting. In the past few years two variations of the above structures, namely, discounting of individual invoices over an online platform and reverse factoring have been popularised by companies to make their cash flows efficient. They are discussed briefly to highlight the legal differences between structures.

#### 3.1. *Open account SCF programme*

Open account SCF programme is mostly popular in the US and some parts of Europe. It involves three parties, namely the supplier, the buyer and the bank. The supplier signs up to negotiate and sell its receivables owed by the buyer to the bank. The supplier sells goods to the buyer, generating an invoice that it posts on the SCF platform for the buyer's confirmation. Once the buyer confirms the invoice as valid, the related receivable becomes eligible for purchase by the bank. Only confirmed invoices are eligible for purchase; so a specific transaction can be sold if both the supplier and the buyer agree to have it sold. In confirming the invoice, the buyer agrees that it will pay the bank the full amount of the invoice on its due date without any claim, abatement, deduction, reduction, or offset of any kind. This confirmation enables the bank to look directly to the buyer for payment. The buyer may still request deductions and make similar claims against the supplier, with those offsets potentially applying to future invoices, but the buyer will not be permitted to challenge the amount owed on the receivable sold to the bank.

The open account based SCF programme became popular in the US when it established the unitary model of security interest on personal property, based on Article 9 of the Uniform Commercial Code (UCC). The unitary concept of security interest brought all secured transactions on personal property and fixtures under the same roof where a transaction in substance secures payment and performance of an obligation regardless of its form or who has title to the collateral. Australia, Canada and New Zealand are some of the prominent jurisdictions which has enacted their laws based on a similar unitary model. The Continental European countries do not follow the unitary concept of security interests as in the US and consequently, title and receivables financing are carried out based on personal property security laws.

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<sup>15</sup> The tax structure, accounting standards, and the regulatory environment of financial institutions of a jurisdiction also have an important effect. They are left outside the scope of this paper.

<sup>16</sup> Unfortunately, such regulations may also be viewed as new non-tariff measures that increasingly pose challenge to the international trading community. Moreover, extraterritorial application of such laws adds to the concern. The regulations on cross-border data flows can take variety of forms; for example, some governments require prior consent for data transfers abroad, some require local servers to be established within the territory, some have outright ban of personal citizens' information flow out of the economy, and some require copies of information sent abroad to be stored domestically.

### 3.2. Negotiable instrument based SCF programme

Negotiable instrument based SCF programme is the dominant structure in many jurisdictions outside the US and Europe as selling intangibles can be cumbersome and may expose the investor to additional legal risks, such as fraud and insolvency. The parties involved in such a programme are the supplier, the bank and sometimes the buyer. The supplier submits invoices, which the buyer approves. However, the supplier also creates a draft, a bill of exchange, a negotiable promissory note, or any other form of negotiable instrument. The supplier sells the negotiable instrument to a bank, who then takes physical possession of the instrument, and presents it to the buyer for payment on the invoice maturity date. The invoices sold as negotiable instruments give the bank priority against claims of the buyer's other creditors, including in a bankruptcy proceeding. The law relating to negotiable instruments apply to such transactions.

### 3.3. Non-recourse receivables purchase

Receivables purchase is used worldwide and involves primarily the supplier and the bank. It entails a supplier selling to the bank its rights to certain accounts receivable owed by a buyer. The buyer does not have to confirm each invoice before the receivable can be sold. The downside of this arrangement for the bank is that there is no direct confirmation from the buyer that it will pay the bank. Thus, the bank has to make sure that what it is acquiring from the supplier is a valid and enforceable claim against the buyer. The bank usually conducts significantly more due diligence on the supplier before entering into such a transaction, and ensures that the supplier is transferring the receivables via a legal true sale.

## 4. SCF Dependent on Network Effects and Legal Framework: Swiss Post Case

A contract for sale is the starting point of any commercial transaction and it is closely interrelated with other contracts relating to carriage of goods, insurance and financing. Once the goods are shipped through a LSP, the seller issues an invoice to the buyer and is entitled to payment within a stipulated number of days. The LSP as transporter has knowledge about the location of the goods and may also physically possess the goods. In addition, it often holds valuable insight on the seller's and buyer's business conditions. Over the years LSPs have developed their own practices to track goods in international supply chains, and now they have the possibility to turn this knowledge into an opportunity to develop related financial services.

An alternative approach in the supply chain can be that a LSP is not only responsible for transport, handling and storage, but also emerges as a financier. For instance, a Swiss LSP buys the goods from the manufacturer and obtains an interim legal ownership before selling them to manufacturers' customers after a certain time. The LSP is also supported by a purchase guarantee from the manufacturer, which the manufacturer has negotiated in framework agreements with its customers. The rationale of this alternative approach is to achieve an improvement in the inventory financing within the supply chain by adopting a "network perspective". The financial justification for assuming ownership to the goods by the LSP has already been discussed in financial literature.<sup>17</sup> It is submitted that there is a legal reasoning as well that necessitates transfer of ownership to the LSP. Under Swiss law, creating a security interest in moveable property requires more than a pledge agreement. Since there is no security interest register in which the information about a pledge agreement is publicly available, an enforceable pledge of moveable property requires that the pledgor physically deliver the property to the lender in compliance with the *Faustpfandprinzip* (which literally means the fist pledge principle).<sup>18</sup> A Swiss court will not consider a pledge to be perfected if the transaction structure is an obvious attempt to circumvent the *Faustpfandprinzip*. Therefore, the transfer of ownership to the LSP is necessary for compliance with Swiss laws.

<sup>17</sup> Swiss Post that offers both logistics and financial services teamed with P&G to offer the above-described SCF programme in Switzerland. See Erik Hofmann, (2009), "Inventory financing in supply chains: A logistics service provider-approach", International Journal of Physical Distribution & Logistics Management, Vol. 39 Iss 9 pp. 716 — 740, <http://dx.doi.org/10.1108/09600030911008175>

<sup>18</sup> See Wyss, L., The pledge of moveable property in secured financing transactions, Walder Wyss & Partners, NewsLetter No.78 June 2008, <https://www.walderwyss.com/publications/513.pdf>

The above illustration shows that the commercial laws of a jurisdiction and the level of enforcement determines the environment in which contracting occurs. Commercial law specifies the property rights associated with the commercial transaction, and enforcement of these rights determines the confidence of contracting parties in the contract. A jurisdiction's commercial laws should clearly define how a collateral lien can be perfected, how collateral priority is determined, and how notification of a lien is made. The "World Bank Doing Business — Measuring Business Regulations" publishes a Getting Credit score for countries by measuring the legal rights of borrowers and lenders with respect to secured transactions.<sup>19</sup>

## 5. *Visibility, Competition and Collaboration in Supply Chains to Enhance SCF*

In the Swiss Post example, the LSP linked the cargo to the purchase order, which resulted in efficient financing of the supply chain. Swiss Post could execute this SCF solution as the setting was national and it had both in-house logistics and financial services that provided the visibility and financial strength to offer competitive financing solution. This may not be true for most LSPs and therefore it would be reasonable to expect that they cooperate with banks to combine visibility and financial strength.

### 5.1. *Collaboration to Increase Visibility and Reduce Risk*

Banks find lending to SMEs costly and risky than lending to MNCs. Transaction costs in terms of administration and monitoring are higher, information less transparent and, moreover, the availability of adequate collateral for covering small firms' higher default risk is limited.<sup>20</sup>

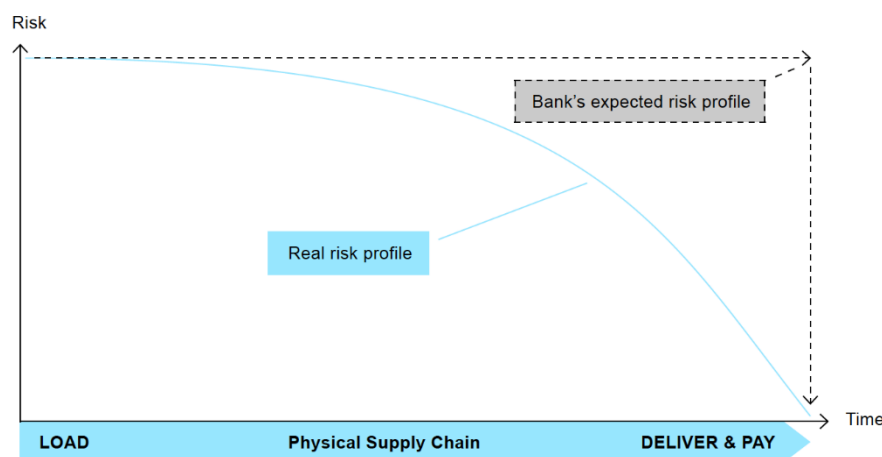


Figure 1: The real risk profile of the supply chain vs. the one expected by the bank.<sup>21</sup>

Figure 1 above shows that a bank determines the fee based on the expected risk profile of the physical supply chain. The blue line shows that a more competitive fee can be charged if the bank has more information available to adjust its risk profile as the physical supply chain evolves. The LSPs hold such information that they can share with banks and create value.

<sup>19</sup> World Bank, Doing Business, Measuring Business Regulations, <http://www.doingbusiness.org/methodology/getting-credit>

<sup>20</sup> *Supra*, note 11.

<sup>21</sup> Bryant, C., Camerinelli, E., "Supply Chain Finance: Euro Banking Association European market guide", version 2.0, June 2014, p. 80, [https://www.abe-eba.eu/downloads/knowledge-and-research/1406\\_EBA\\_Supply\\_Chain\\_Finance\\_European\\_Market\\_Guide\\_Second\\_edition.pdf](https://www.abe-eba.eu/downloads/knowledge-and-research/1406_EBA_Supply_Chain_Finance_European_Market_Guide_Second_edition.pdf)

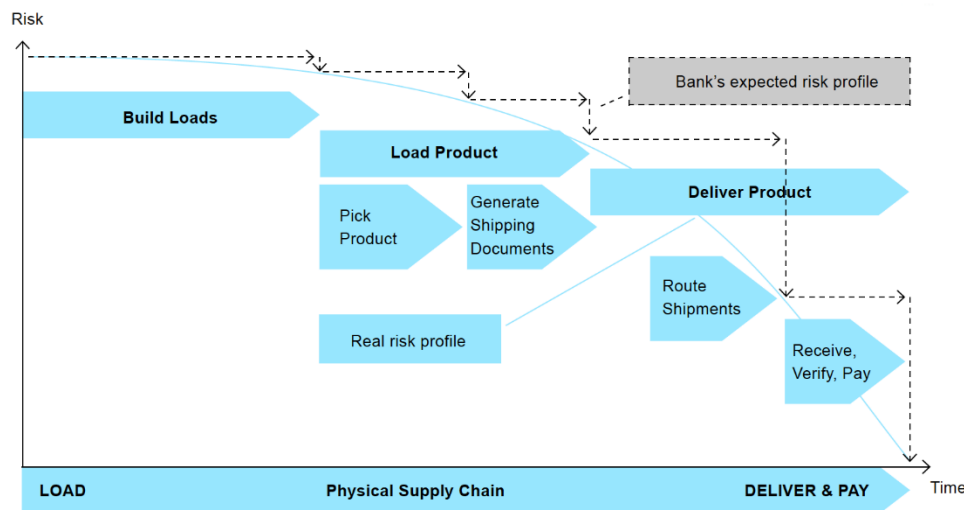


Figure 2: Making the real risk profile of the supply chain visible.<sup>22</sup>

Figure 2 above shows that information can be used to reduce the fee that a bank charge, not because risk is reduced but because it is more accurately priced. Therefore, the LSPs can be seen as valuable partners by banks and financial institutions to make SCF event-driven.

### 5.2. Collaboration on a Collective Basis is the Future of SCF

A supply chain covers the entire chain, starting from the first supplier to the end customer. This is not a serial process but a complex, inter-related network of partners, suppliers, contract manufacturers, packers, resellers, etc. The focus of SCF is on creating liquidity in the supply chain through various buyer or seller-led programmes. However, current programmes are restricted in certain portions of the chain. To encourage the development of SCF programmes across the entire chain, it is necessary to have both competition and collaboration between various market participants in the SCF space. As competition intensifies between participants, collaboration would be the key to deliver a successful programme. Collaboration between banks, alternative financiers, LSPs, etc., increases the possibility of electronic exchange of purchase orders, shipping and delivery documents, invoices, etc. across trusted and reliable B2B networks.

One possible way forward is to create a four-corner model such as the BPO that will promote collaboration between business entities on a bilateral basis through partnerships or commercial contracts, technical outsourcing, and cooperation with B2B networks. But, this is a closed model and entails high investment for both the banks and the clients. Another possibility is that market participants collaborate on a collective basis by focussing on their core area of competence for overall market development and also to benefit individually. This is an open model based on peer-to-peer approach which would allow increased potential for risk distribution with other financing partners, higher scalability and potential for market penetration, and additional sources of funding for businesses. This would also give rise to joint-industry initiatives in the areas of regulation, standards, and infrastructural development. However, there are challenges that include increased commercial and operational complexity, technical interdependency and the need for well-defined standards, and friction between market players over revenue sharing.<sup>23</sup>

## 6. UNCITRAL Instruments can Advance SCF

Several international instruments may be necessary to promote SCF throughout the supply chain. However, the various instruments will have different objectives — whether a fiduciary purpose, the promotion of international trade, or other socio-economic policies. This paper argues that efforts of UNCITRAL, namely, the draft Model Law on Electronic Transferable Records, the Rotterdam Rules, the

<sup>22</sup> *Ibid.*, p. 82

<sup>23</sup> *Ibid.*, p. 111



Model Law on Secured Transactions, the on-going deliberations at Working Group I on the draft legislative guide on an UNCITRAL limited liability organization, and the deliberations at Working Group IV on contractual aspects of cloud computing and the legal issues related to identity management and trust services, can increase visibility in global supply chains.

### 6.1. *Electronic Records to Promote Dematerialised Information Exchange*

Large enterprises see value in using electronic data interchange provided by large LSPs, such as DHL or UPS. These large logistics service providers have their enterprise resource planning (ERP), transport management and logistics systems that are connected to the ERP system of the large enterprise at one end and with customs and port authorities interface on the other end. Generally, SMEs do not have advanced internal ERP systems and do not use the services of such large logistics service providers. They continue to use a mix of electronic and paper based information and documentary exchange, which puts them at a competitive disadvantage vis-à-vis the large enterprises. Moreover, SCF is not efficiently extended to SMEs as they are outside the range of electronic visibility.

In 2008, the United Nations General Assembly adopted the Rotterdam Rules.<sup>24</sup> One of the objectives of the Rotterdam Rules is to facilitate e-commerce by establishing a legal framework for electronic bills of lading.<sup>25</sup> The provisions on electronic transport records in chapters 3 and 8 of the Rotterdam Rules are specifically designed to fill the gap in the area of carriage of goods in relation to e-commerce. The Rules also contain three separate chapters dealing with delivery of the goods, the rights of a controlling party, and the transfer of rights,<sup>26</sup> which may serve as a way to solve the problem of how to provide for negotiable electronic transport records.<sup>27</sup> The Rules has not yet entered into force and therefore the provisions are not currently in use.

To promote electronic communications in international trade and also support the Rotterdam Rules, UNCITRAL Working Group IV on Electronic Commerce in November 2016 finalized the Model Law on Electronic Transferable Records.<sup>28</sup> This Model Law aims to facilitate dematerialization of all paper-based transferable documents or instruments that allow to claim the payment of a sum or the delivery of goods.<sup>29</sup> One of the difficult issues that this Model Law will resolve relate to the requirement of physical possession of the paper document. Article 10 of the Model Law provides a functional equivalence rule for the possession of a transferable document or instrument. Functional equivalence of possession is achieved when a reliable method is employed to establish control of that record by a person and to identify the person in control. The notion of control when used as a substitute for possession requires a reliable method for identifying the current party in control of a specific electronic record as the said notion typically focuses on the identity of the person entitled to enforce the rights embodied in the electronic transferable record.<sup>30</sup> The

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<sup>24</sup> The principal goal underlying the development of the Rules is the creation of a modern and uniform law concerning the international carriage of goods by sea, in order to reduce transaction costs, increase predictability and stability, and engender greater commercial confidence in international maritime commerce. The Rotterdam Rules have so far received 25 signatures and 3 ratifications, by a mix of developing and developed countries, including strong seafaring and trading nations, as well as traditional carrier and shipper nations. See “Status of the Rotterdam Rules” [http://www.uncitral.org/uncitral/en/uncitral\\_texts/transport\\_goods/rotterdam\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/transport_goods/rotterdam_status.html). Pursuant to article 94, the Convention requires ratification or accession by at least 20 states to enter into force.

<sup>25</sup> The Rotterdam Rules uses the term “negotiable transport documents” to refer to bills of lading and the term “non-negotiable transport documents” to refer to sea waybills. The Rules uses the term “electronic transport records” to refer to the electronic equivalent of bills of lading.

<sup>26</sup> Chapters 9, 10 and 11 of the Rotterdam Rules.

<sup>27</sup> For a detailed discussion see van der Ziel, G. J., “Delivery of The Goods, Rights Of The Controlling Party And Transfer Of Rights”, *Journal of International Maritime Law* 14: 606, (2008). See also, Basu Bal, A., Electronic Transport Records: An Opportunity for the Maritime and the Logistics Industries. *Journal of Transportation Law, Logistics and Policy* 81(1): 37, (2014).

<sup>28</sup> *Supra*, note 4.

<sup>29</sup> An indicative list of transferable documents or instruments includes: bills of exchange, cheques, promissory notes, consignment notes, bills of lading, warehouse receipts, cargo insurance certificates and air waybills.

<sup>30</sup> See draft article 9, *supra*, note 4.

method of identification may be accomplished through a closed system<sup>31</sup>, or through an open system<sup>32</sup>. Under the draft model law, the notion of original and uniqueness has been connected to control. Emphasis has been given to reliably ensure that the claim may be presented to the debtor only once.<sup>33</sup>

## 6.2. Industry Standards as a Governance Technique

Limited international legislation in an area often makes the market adopt private standards to create trust among participants. International institutions in their attempt to keep up with technological and industry convergence may align their instruments to voluntary standards. A small but potentially significant inclusion of such a provision that refers to industry standards in an international instrument is article 12(a)(vii) of the UNCITRAL Draft Model Law on Electronic Transferable Records. This article that deals with “general reliability standard” provides:

For the purposes of articles 9, 10, 11, 13, 17, 18, and 19, the method referred to shall be:

(a) As reliable as appropriate for the fulfilment of the function for which the method is being used, in light of all relevant circumstances, which may include:

...

(vii) Any applicable industry standard; or ...

In the above provision, firstly, it is to be noted that the word ‘may’ is an option and should not be read as an empowering formulation. Secondly, the wording ‘any applicable industry standard’ does not clarify what industry the standards are referring to and who in that industry will set the standards. Neither does it say whether the industry is composed of its participants, or is it some kind of a regulatory body. It may well be that the standards referred to in the article are the one agreed and adopted in a relevant industry. Such industry based mechanism for setting standards may be favoured in cases where public sector bodies do not have the necessary technical knowledge and where existing incumbents in the industry have a strong interest in influencing the development of standards. For example, bills of lading standards may be developed by the maritime industry; and trade finance standards may be developed by the banking industry. Thus, accepted standards are the ones that are recognized in the industry within which the parties to the transaction operate. However, if a supply chain view were to be adopted, it would be difficult to restrict the definition of the accepted standards based on the participants of the relevant industry, because new peers might be coming in from different industries.

Be that as it may, it is not impossible to impose standards, and that in due course it can be ensured that the standards are set in a fair way so that the newcomers to the market would not be precluded. Technological and industrial convergence has made it necessary for policymakers to cooperate and deliberate more horizontally, as the core of digitization is networking. International institutions should work closely with private standard setting entities, as it is increasingly relevant to rely on private standards created by highly specialized professionals. It is submitted that voluntary standards may emerge as a governance technique to regulate trade in the digital era and industry associations can play an important role in formulating such standards.

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<sup>31</sup> The closed system includes the token model “which identifies the person in the record itself” and the registry model “which identifies the person in a separate registry.” UNCITRAL, “Legal issues relating to the use of electronic transferable records”, A/CN.9/WG.IV/WP.115, (2011).

<sup>32</sup> The open system is decentralised and uses block chain token which does not identify the holder in the record, i.e. in the token itself. A block chain ledger displays the addresses in which tokens are kept, the addresses are cryptographic identities (pseudonyms), and the private keys corresponding to the addresses are secret. See Takahashi, K, “Blockchain Technology and Electronic Bills of Lading”, *Journal of International Maritime Law* 22: 209 (2016).

<sup>33</sup> See draft Article 11, *supra*, note 4.



### *6.3. Model Law on Secured Transactions to Promote Credit Availability*

The UNCITRAL Model Law on Secured Transactions is based on the UNCITRAL Legislative Guide on Secured Transactions. The Model Law is intended to assist States in developing modern secured transactions laws with a view to promote the availability of credit. Taking a security interest enables a creditor to have priority over competing creditors if the debtor files bankruptcy. The Model Law is developed as concise text, to be used as tool for implementation of the Guide's recommendations and setting out a regime for secured transactions in 107 Articles plus 33 Model registry provisions. Many of the solutions provided in the Model law are inspired by Article 9 of the US UCC, which governs security interests and applies to any transaction that creates a security interest in personal property.

The Model Law provisions integrate the treatment of all transactions fulfilling a security function and the replacement of a wide range of security devices with a single concept, the security interest. Under the Model Law a security interest can be made effective against third parties by registration, by the taking of possession or, in the case of financial collateral, the taking of control. The notice filing through registration can be done in advance of the security being created, so that the register is then a warning that a security has been or may be taken. Only one filing is required for all transactions between the same parties involving the same kind of collateral. The priority rules of the Model Law are designed to produce a commercially reasonable outcome for typical disputes. Filing is a priority point, in that priority between security interests generally depends on the date of perfection.

### *6.4. Increase Visibility for SMEs by Reducing Information Asymmetry*

Information asymmetry has been a challenge for small and medium businesses when they seek finance to fuel their growth. Since the 1960s, private sector finance has played an increasingly critical role in driving economic growth. However, lesser disclosure requirements and often, shorter formal trading history make it harder and more expensive for investors and financiers to acquire the required information to make accurate assessments about creditworthiness. As a result, SMEs continue to find it hard to get the finance they need to participate in the formal economy. Also, stringent banking regulations have further excluded SMEs through KYC and AML requirements.

Lack of visibility prevents SMEs from providing the information required by banks to grant access to debt. Also, SMEs are not able to signal to the trading partners their quality as suppliers. For the past several years, regulators around the world have recognized that jurisdictional disclosure and registration measures need to be redesigned to encourage SME trade participation and boost economic growth. Several options have been designed in various parts of the world to break down information asymmetry at the outset of market entry.

UNCITRAL Working Group I is currently deliberating on legal issues surrounding the simplification of incorporation and to good practices in business registration, both of which aimed at reducing the legal obstacles encountered by SMEs throughout their life cycle. It is submitted that this initiative along with other initiatives such as a global identifier system can increase visibility and enhance the chances of funding for SMEs.

### *6.5. Liability Rules on Cloud Computing and Identity Management Necessary for Collaboration on a Collective Basis*

In November 2016 UNCITRAL WG-IV started its deliberations on cloud computing, identity management and trust services. For banks the identity of the counterparty is of fundamental importance as it is necessary for verifiability and other regulatory reasons, such as KYC and AML requirements. There are several legal concerns for the identity provider, relying party and the user/data subject. Major among them is liability. Other concerns may relate to data integrity, e-contracts and e-signatures, cyber security law, privacy and data protection law, dispute resolution, etc. Since the deliberations have just started there is room for much discussion on this subject in the near future.

## 7. *Concluding Remarks*

The expansion of SCF programmes throughout the supply chain has to be supported by a robust legal framework. It will result in greater financial inclusion, with the potential to raise SME visibility to improve confidence and transactional efficiency, freeing up capital and other resources to invest in productive output.

With the exception of the WTO Trade Facilitation Agreement<sup>34</sup> entering into force on 22 February 2017, the multilateral trade negotiations are moving at a glacial pace. The new business realities such as digital trade and global value chains need quick action from policymakers. Multilateral initiatives are possibly not well suited to deliver for digital trade in the short run, as many States do not want to commit themselves to such evolving areas without fully understanding the implications. The need for SCF to support SMEs is an immediate problem. Therefore, private law solutions will dominate in the short run and UNCITRAL is possibly the most suited institution to create harmonized laws that can facilitate SCF. The UNCITRAL instruments and initiatives discussed above are new and therefore it can be hoped that States will soon start using them in creating or updating their national legislation.

The use of financial technology can provide opportunity for the next wave of global growth to come from a facilitative approach to law making, combined with an appreciation of how information can be used to achieve positive outcomes. It creates an important opportunity for policymakers, working together, to deliver highly usable policy outcomes and provide benefits for collaboration between the physical and financial layers of the supply chain.

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<sup>34</sup> WTO, “Agreement On Trade Facilitation”, 15 July 2014, WT/L/931, [https://www.wto.org/english/tratop\\_e/tradfa\\_e/tradfa\\_e.htm](https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm).

## *Coordinating Secured Transactions Law and Capital Requirements*

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### *I. Introduction*

The newly adopted Model Law on Secured Transactions crowns a longstanding effort of the United Nations Commission on International Trade Law (UNCITRAL) to facilitate access to finance through secured credit. In the context of security rights, the engagement of UNCITRAL dates back to 1968, when the possibility of designing a modern and harmonized legal framework was considered and followed by exploratory studies.<sup>1</sup> In 2002, UNCITRAL's Working Group VI (Security Interests) commenced its work "on the development of an efficient legal regime for security rights in goods involved in a commercial activity."<sup>2</sup> The rationale for developing a modern and internationally harmonized legal framework for security rights in movables (tangible and intangible assets) is to broaden access to credit at a lower cost and, consequently, further international trade and economic growth. The mandate of Working Group VI was fulfilled in 2007 when UNCITRAL adopted the Legislative Guide on Secured Transactions (Legislative Guide), equipping national law reformers with an instrument to design a modern legal framework for secured transactions along the lines of the recommendations set forth therein. Working Group VI assisted national policymakers with the adoption of two additional instruments complementing the Legislative Guide — the Supplement on Security Rights in Intellectual Property (2010) and the Guide on the Implementation of a Security Rights Registry (2013). Finally, in 2016, the Model Law on Secured Transactions (Model Law) was adopted. These instruments benefited from the discussions that occurred during the last UNCITRAL Congress, titled "Modern Law for Global Commerce" (2007),<sup>3</sup> when several issues pertaining to secured transactions law were discussed using the Legislative Guide as a point of reference. In light of recent economic, social, and technological developments in the last decade, it is now time to re-examine some of those issues and explore new ones in connection with the instruments on security rights adopted by UNCITRAL, particularly the Model Law.

One of the drivers for defining UNCITRAL standards that guide domestic secured transactions law reforms has been the assumption that a modern legal framework allows regulated credit institutions, or banks, to accept a wider range of collateral in order to benefit from reduced capital requirements. Amongst the various issues relating to securing obligations with movable assets, one panel at the 2007 Congress examined the regulatory impact of secured transactions on regulated financial institutions under the Legislative Guide.<sup>4</sup> It was noted then that an expeditiously enforceable security right with the highest priority allows banks to benefit from lower capital charges. The same panel advanced a parallel with mortgages over immovable property, noting that these arrangements are recognized under international capital standards elaborated by the Basel Committee on Banking Supervision (BCBS) as a factor that may reduce the risk associated with a loan.<sup>5</sup> Following this logic, one of the justifications for modernizing

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<sup>1</sup> See Report of the United Nations Commission on International Trade Law on the Work of its First Session (A/7216, 1968) paras. 40-48; Report of the United Nations Commission on International Trade Law on the Work of its Third Session (A/8017, 1970) paras. 139-145.

<sup>2</sup> Report of Working Group VI (Security Interests) on the Work of its First Session (A/CN.9/512, 2002) para. 1.

<sup>3</sup> UNCITRAL, *Modern Law for Global Commerce*, Proceedings of the Congress of the United Nations Commission on International Trade Law Held on the Occasion of the Fortieth Session of the Commission, Vienna, 9-12 July 2007 < [https://www.uncitral.org/pdf/english/congress/09-83930\\_Ebook.pdf](https://www.uncitral.org/pdf/english/congress/09-83930_Ebook.pdf) > accessed 20 June 2017.

<sup>4</sup> UNCITRAL, *Modern Law for Global Commerce* (n 3) 124.

<sup>5</sup> *Ibid.*, It is worth noting that, following the 2007-2008 financial crisis, new capital adequacy standards have been

secured transactions laws along the lines of the Legislative Guide was that security rights in movable property would benefit from a similar regulatory treatment. This expectation also underscores the Model Law, which was designed to be in line with the Legislative Guide, as well as many secured transactions reform projects at the national level. However, such an assumption is not entirely correct and reflects an over-simplification of the functioning of international capital requirements.

It is argued here that the relationship between secured transactions laws and capital requirements should be more carefully explored to ensure an effective coordination between these two critical areas of the law. Our argument builds upon a research project comparing legal and regulatory treatments for certain types of assets — financial collateral and tangible assets — taken as collateral to secure commercial obligations.<sup>6</sup> Through this prism it emerged that secured transactions law and capital requirements, in pursuing different programmatic objectives, namely access to credit and financial stability, are based on a different understanding of what should constitute a valid protection against credit risk.<sup>7</sup> In particular, capital requirements display a traditionally sceptical attitude towards the possibility of using movable assets as valid credit protection against credit risk. Practical experiences in law reforms at the national level show that banks in a number of developing countries have not been able to significantly increase the volume of secured credit, notwithstanding the implementation of a novel secured transactions law regime. One of the chief reasons for this is the lack of coordination between secured transactions law and capital requirements which, in turn, does not provide an incentive to banks to engage in secured lending when movable assets, such as equipment or receivables, are offered as collateral. To address this and other related issues limiting credit creation through the banking system, different strategies may be developed at the national level.<sup>8</sup> However, these strategies are naturally confined within the perimeters established by the two distinct legal frameworks i.e. secured transactions law and capital requirements. Accordingly, the problem should also be addressed at the international level; precisely by furthering coordination between UNCITRAL instruments and the Basel framework — promulgated by BCBS and composed of the Second and Third Accords (Basel II and Basel III).<sup>9</sup>

Pursuant to the Basel framework, security rights trigger capital charges below the level of those attributed to unsecured credit only if the soundness of individual banks and the stability of the entire banking system are deemed to be preserved. If this is not the case, banks are required to treat secured credit in the same manner as unsecured credit, frustrating the purpose of reforming national legal regimes for secured lending. This is not to say that banks or, more generally, the banking industry, do not benefit from a modern secured transactions regime. On the contrary, if legal certainty is ensured and the creation, priority, publicity, and enforcement of security rights are governed by a predictable and coherent legal regime, banks are likely to extend loans to borrowers that absent such a modern secured transaction law would not be possible or issued at a high cost. Nonetheless, the lack of coordination between the efforts to modernize the law pertaining to security rights in movable assets and the efforts to strengthen the stability of the financial system may generate the unintended consequence of limiting bank loans generating a gap in the market for secured credit. Such a gap is likely to be filled by lenders operating outside the banking system, within a sector commonly referred to as “shadow banking.”<sup>10</sup>

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defined and are currently debated. In general, the new approaches to calculate capital charges over immovable property are more stringent than the one considered at the time of the 2007 UNCITRAL Congress.

<sup>6</sup> Giuliano Castellano and Marek Dubovec, ‘Regulatory Perspectives on Security Rights’ (*mi meo* 2017).

<sup>7</sup> Ibid.

<sup>8</sup> For other reasons impeding the use of collateralized transactions — such as the lack of expertise and the need for training on asset-based lending — and for a possible solution to address these issues, including recommendations on how to coordinate secured transactions law and capital requirements at the national level, see Giuliano Castellano and Marek Dubovec, ‘Bridging the Gap: The Regulatory Dimension of Secured Transactions Law Reforms’ Uniform Law Review (*forthcoming* 2017/2018).

<sup>9</sup> BCBS, International Convergence of Capital Measurement and Capital Standards — A Revised Framework (BIS 2004, revised 2006) (Basel II); BCBS, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking System (BIS 2010, revised 2011) (Basel III).

<sup>10</sup> See Financial Stability Board, Strengthening Oversight and Regulation of Shadow Banking: Recommendations of the Financial Stability Board (Basel 2011). In the literature, see Steven Schwarcz, ‘Regulating Shadow Banking’ (2012) 31 Review of Banking and Financial Law 619.

It follows that furthering cooperation and coordination between UNCITRAL and international prudential regulators, notably the BCBS in conjunction with the Financial Stability Board, is of pivotal importance, at least for three reasons. First, coordination would reinforce the understanding of the differing objectives of these two legal regimes governing secured credit. This is, in essence, an attempt to build bridges. Second, UNCITRAL and BCBS would better achieve their objectives in discharging their tasks in a coordinated fashion. Third, the result of this inter-institutional coordination would offer guidance to national law reformers and regulators, fostering cooperation and capacity building in both areas of law. Overall, the instruments developed by UNCITRAL would contribute to addressing stability concerns as part of its broader agenda of promoting sustainable development and supporting innovation. Similarly, BCBS, alongside other relevant organizations, would be in a position to assess whether and, if so, in what instances secured transactions laws contribute to the stability of credit-based economies. The proposed coordination entails an inter-institutional dialogue potentially leading to a recalibration of international legal and regulatory standards. More immediately, a Guide to indicate how national law reforms may be implemented to promote, simultaneously, access to credit and financial stability could be prepared to ensure coordination between domestic regulatory environments and the Model Law.

## *II. The Perimeters of the Issue: The Problematic Intersection between Secured Transactions Law and Capital Requirements*

We have noted elsewhere that the dissonance between secured transactions law and prudential regulation stems from different rationales and operational logics characterizing these two areas of law.<sup>11</sup> While secured transactions law is concerned with the establishment of a legal environment that is conducive to private negotiations in order to stimulate economic growth, prudential regulation, through capital requirements, responds to a regulatory rationale that is sustained by the necessity of controlling the risk associated with banking activities. Capital requirements are imposed on banks with the intent of preventing excessive risk-taking, which may have detrimental implications for the stability of individual banks as well as for the entire financial and economic system. This reflects a twofold rationale. First, following the paradigms of micro-prudential regulation, minimum capital standards are concerned with the solvency of individual banks. Second, in line with the increasing need to focus on the macro-prudential dimension of financial regulation, capital requirements aim at maintaining the stability of the financial system in its entirety. Upon these premises, capital requirements prescribe the standards to calculate the amount and the composition of regulatory capital, i.e. that portion of own (or “unborrowed”) funds that banks must hold against the risks generated by their operations. Promoting economic growth also permeates the debate over the definition of an optimal level of regulatory capital.<sup>12</sup> In this respect, capital requirements should not stifle banks’ ability to expand the availability of credit in support of economic growth and development. Hence, capital requirements — by controlling the associated risk — strike a balance between economic growth and financial stability, by influencing and, to an extent, limiting the lending choices of individual banks.

At the heart of the Basel framework to calculate regulatory capital is the Risk Weighted Asset (RWA) approach. RWA is a form of legal technology that establishes capital requirements in proportion to the level of risk taken by a bank. To each and every financing operation corresponds a coefficient that should be used to calculate the corresponding capital charge. Such coefficients reflect the likelihood of repayment and the level of liquidity for different classes of financing operations and borrowers. To calculate risk-weighted capital charges, banks may adopt different methodologies. Basel II, in fact, introduced three methodologies to determine the regulatory capital. Under the basic methodology, known as “standardized approach,” Basel II and Basel III statutorily prescribed the RWAs to calculate capital charges in accordance to the

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<sup>11</sup> See Castellano and Dubovec (n 6).

<sup>12</sup> See Jihad Dagher and others, ‘Benefits and Costs of Bank Capital’ (2016) IMF Staff Discussion Note SDN/16/04; Anat Admati and Martin Hellwig, *The Bankers’ New Clothes: What’s Wrong with Banking and What to Do About It* (Princeton University Press, Princeton 2014).

riskiness of various operations.<sup>13</sup> For instance, small business loans are risk-weighted at 75 percent,<sup>14</sup> and only security rights over highly liquid assets, such as bank accounts, may be considered to reduce credit risk and thus capital charges. RWAs feed into the capital adequacy formula and, assuming there are no other risks, capital charges are calculated by multiplying: (1) the loaned amount, by (2) the risk-weight, by (3) eight percent. By way of example, a small business loan with a value of 100,000 euros requires a capital charge equal to or greater than 6,000 euros. Under the standardized approach, RWAs are defined by regulators and the possibility of considering factors mitigating credit risk is limited. With the introduction of two additional Internal Rating-Based (IRB) methodologies — the Foundation Internal Rating-Based (F-IRB) and the Advanced Internal Rating-Based (A-IRB) — banks have been allowed, upon regulatory approval, to adopt their own estimations to adjust RWAs and ultimately benefit from lower capital charges. The probability of default and the resulting losses associated with lending operations may be calculated using the banks' own estimations. Hence, through IRBs, the risks associated with a specific lending operation may be further mitigated taking into account specific factors, such as the protection offered by a security right in tangible assets or receivables. However, even under the IRB variants, a security right may lead to reduced capital charges only if banks comply with specific regulatory requirements.

#### *A. Secured Transactions in the Basel Framework: Credit Risk Mitigation*

Regardless of the methodology adopted, to unveil how secured transactions are considered in the Basel framework, it is necessary to look at the function that those instruments are to perform from a regulatory perspective. Secured transactions are funded credit protections, belonging to the broader category of Credit-Risk Mitigation (CRM) techniques.<sup>15</sup> CRMs are primarily designed to lessen the risks associated with individual financing operations and, eventually, with a bank's entire portfolio of financing operations. When CRM techniques are employed, the resulting RWA charge should be lower than that imposed for an otherwise identical transaction not supported by any CRM.<sup>16</sup> However, if providing inadequate credit protection, secured transactions may result in capital charges that correspond to those applied to unsecured credit.<sup>17</sup> This is because collateralized transactions generate new risks, including: legal risk, hindering the exercise of secured creditors' rights; operational risk, arising from defective procedures to monitor, inspect, or assess the value of encumbered assets; and liquidity risk, arising from difficulties in the disposal of collateral.<sup>18</sup> A security right reduces a capital charge below the level of that applicable to unsecured loans only if it ensures the appropriate management of those risks, thus promoting the soundness of individual banks and the stability of the entire banking system.

Under the Basel framework, to determine whether a given CRM reduces capital charges, banks must deploy specific procedures and follow the prescriptive rules of either the standardized approach or, if authorized by national regulators, one of the two IRB variants. Subsequently, depending on the methodology adopted, various provisions apply to determine if a given type of transaction constitutes an eligible CRM and its corresponding coefficient for the computation of the risk-weighted capital charge.<sup>19</sup>

<sup>13</sup> Kern Alexander, 'The Role of Capital in Supporting Banking Stability,' in Niamh Moloney, Eilís Ferran, and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* 344 (OUP, Oxford 2015).

<sup>14</sup> Basel II (n 9) para. 69.

<sup>15</sup> CRMs are defined as techniques whereby "exposures may be collateralized by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk;" Basel II (n 9) para. 109.

<sup>16</sup> Basel II (n 9) para. 113. This principle is a mainstay for CRM and has been restated in BCBS, *Second Consultative Document: Revisions to the Standardised Approach for Credit Risk* (BIS 2015), issued for consultation on 11 March 2016 (Second Consultative Document) para. 104.

<sup>17</sup> There are some exceptions to this rule and in some instances non-eligible CRMs may also result in lower capital charges; see Basel II (n 9) para. 77. However, the application of these exceptions does not affect the regulatory treatment of security rights here examined.

<sup>18</sup> Basel II (n 9) para. 115.

<sup>19</sup> This may occur in different fashions. In general, if a coefficient is not statutorily attributed to a specific operation, the risk-weight of the collateralized transaction results from the reduced exposure calculated after the CRM is multiplied by the risk-weight of the counterparty; Basel II (n 9) para. 148.

For CRMs to mitigate credit risk and thus discount capital charges, the Basel framework identifies a series of specific requisites.<sup>20</sup> Encumbered assets should be sufficiently liquid with a predictable value over time or included in a list of assets that contains collateral considered to be very liquid, such as gold, bank accounts, and certain types of debt and equity instruments.<sup>21</sup> Moreover, banks should demonstrate — through written and independent legal opinions — that they have the right to liquidate (or retain) the encumbered asset promptly in the event of the grantor’s default or insolvency, in all relevant jurisdictions.<sup>22</sup> The intent of these provisions is to ensure that lower capital charges correspond to lower levels of credit and liquidity risk by focusing on the effective realization of the value of encumbered assets. Legal certainty and enforceability of security rights are of paramount importance and they are reflected in the entire set of granular provisions concerning the eligibility of CRMs for different classes of assets and types of transactions. Yet, rather than looking to the secured transactions legal framework for defining what legal certainty and efficient enforcement entail, the Basel framework appears to be primarily focused on identifying assets that are easily sold in secondary markets and for which enforcement is generally more expeditious. Through these lenses, the resulting regulatory framework strongly privileges transactions secured with liquid assets, such as financial collateral, over those that are less liquid, such as equipment. Movable assets taken as collateral are considered eligible credit protections only when banks adopt one of the IRB variants.<sup>23</sup>

### *B. Capital Requirements Meet Secured Transactions Law*

The regulatory understanding of what constitutes an eligible credit protection reveals a number of discrepancies with the legal framework anticipated by the Model Law, some of which are illustrated in this section. First, the Basel framework requires the security agreement to contain a detailed description of the movable assets.<sup>24</sup> On the contrary, the Model Law recognizes that a reference to “all assets,” or to all movable assets within a category, suffices.<sup>25</sup> Second, the Basel framework does not consider how banks may exercise their right to conduct regular inspections to ensure the integrity of the encumbered assets.<sup>26</sup> Hence, the implementation of the relevant provisions from the Model Law is *de facto* irrelevant to this end.<sup>27</sup> It thus remains to be determined whether a requirement to inform the grantor prior to any inspection, which may be agreed on by the parties under the Model Law, would impair the effectiveness of the credit protection, from a prudential regulation perspective. Third, capital requirements demand that banks be able to rapidly enforce their rights by retaining or liquidating encumbered assets in the event of the financial distress or insolvency of the grantor. For security rights in tangible assets, the Basel framework compels banks to ensure that the value of the collateral may be realized within a reasonable timeframe. Also in this respect, legal systems have adopted different approaches. The Model Law, for instance, prescribes that the secured creditor must provide a notice of the intention to repossess the encumbered asset.<sup>28</sup> It is uncertain whether such a requirement corresponds to the prudential expectation of rapid and effective enforcement of security rights. Fourth, the Basel framework establishes that only security rights enjoying first priority are eligible credit protections.<sup>29</sup> The problem is more complex, however, as in most legal systems, preferential claims reflect specific policy choices.<sup>30</sup> Thus, a precise graduation of competing claims is often

<sup>20</sup> The regulatory framework for CRMs is contained in Basel II and their treatment is specified for the standardized and IRB approaches. It comprises two methods, i.e. simplified or comprehensive; see Basel II (n 9) para. 121. The framework is currently under revision following the Second Consultative Document (n 16) Annex 1. The Capital Requirements Regulation adopted in the EU contains most of the proposed changes; see Castellano and Dubovec (n 6).

<sup>21</sup> For the general principles on CRMs, see Basel II (n 9) paras. 123 and 125; for the list of eligible financial collateral, see Basel II (n 9) para. 145.

<sup>22</sup> Basel II (n 9) para. 118.

<sup>23</sup> Basel II (n 9) paras. 521 and 522.

<sup>24</sup> Basel II (n 9) para. 522.

<sup>25</sup> UNCITRAL Model Law art 9.

<sup>26</sup> Basel II (n 9) para. 522.

<sup>27</sup> According to the Model Law, a secured creditor may inspect the collateral, as established by the agreement between the parties, but in a commercially reasonable manner. UNCITRAL Model Law art 53(2).

<sup>28</sup> UNCITRAL Model Law art 77(2)(c).

<sup>29</sup> Basel II (n 9) para. 522.

<sup>30</sup> See José M Garrido, ‘No Two Snowflakes are the Same: The Distributional Question in International

difficult to determine. Moreover, depending on the characterization of a given security right (e.g. an acquisition security right), a different priority status may be attributed.<sup>31</sup> A fifth issue relates to registration. The Basel framework generally establishes that banks must take the required actions to fulfil legal requirements to ensure “the enforceability of security interest (e.g., by registering a security interest with a registrar).”<sup>32</sup> However, this locution may lead national lawmakers (and regulators) to intend registration as the only mechanism to render a security right effective against third parties.<sup>33</sup> Furthermore, given that the Basel framework does not differentiate among registration systems, a law that requires the registration of the actual security agreement and its review by a registrar prior to its entry into a paper-based system, may accord with international capital requirements similarly to a law that establishes an electronic registry system where a simple notice with respect to a security right suffices.

*C. Identifying the Consequences of an Uncoordinated Interaction between Capital Requirements and Modern Secured Transactions Law*

A direct consequence of the thus far uncoordinated co-existence of these two areas of law is the reduced effect of secured transactions reforms. The provisions on eligible collateral clearly prioritize financial instruments and, to a more limited extent, receivables, thus failing to provide the same level of credit-cost reduction for grantors involved in farming or manufacturing, whose assets are crops or equipment. One of the reasons for this dichotomy is the difficulty in assessing the value of tangible collateral, which is comparatively higher for used equipment than for financial instruments or receivables. Furthermore, the Basel framework reflects the legitimate concerns about the liquidity of tangible assets that are more difficult to dispose of upon default, compared to offsetting a balance on a deposit account.<sup>34</sup> Historical data on tangible collateral is often unreliable or non-existent due to the absence of secondary markets and the inability of banks to properly assess and monitor their value. It follows that reforming secured transactions laws per se is not sufficient to broaden access to credit extended through the banking system.

A second and related effect is that the implementation of a reformed secured transactions law is more likely to benefit those lenders that are not affected, or less affected, by capital requirements, such as micro and online lenders, and lessors. In fact, the stringent requisites set forth by capital requirements naturally induce banks to be selective when considering certain assets as security for loans. The banking industry’s retraction from these lending operations leaves part of the demand for (secured) credit unmet, widening a gap that is increasingly filled by non-bank operators, which are not subject to capital requirements. These lenders are less constrained to cater to borrowers deemed too risky for banks. Higher interest rates may be charged to these borrowers not only in order to compensate for greater risks, but also because non-bank lenders’ cost of capital is higher as compared to regulated banks. Ergo, the sole adoption of a modernized and simplified legal regime for securing obligations with movable assets, may broaden access to secured credit in terms of the types of potential borrowers, but, given the greater involvement of non-bank operators, may not necessarily reduce the cost of secured credit.

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Bankruptcies’ (2011) 46 Texas International Law Journal 459.

<sup>31</sup> Floating vs fixed charges.

<sup>32</sup> Basel II (n 9) para. 123.

<sup>33</sup> For instance, the European Banking Authority (EBA) noted that: “[a] lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status;” EBA, Draft Regulatory Technical Standards on Assigning Risk Weights to Specialised Lending Exposures under Art 153(9) of Regulation (EU) No 575/2013 (CRR) (2015) Consultation Paper EBA/CP/2015/09, at n 43. For a more detailed examination of the implementation of the Basel framework in Europe, see Castellano and Dubovec supra (n 6).

<sup>34</sup> See David Clementi, Risk Sensitivity and the New Basel Accord, Speech by Deputy Governor of the Bank of England (London, April 2001).



### *III. Concluding Remarks: Towards a More Structured Coordination*

From the above, it appears that coordination between secured transactions law and capital requirements is an essential piece to foster innovation and sustainable development via legal reforms. Such coordination is needed to ensure that legal rules promoting access to credit are also informed by financial stability considerations, and vice versa. Ideally, the Basel framework should reference international standards that exemplify a modern secured transactions system, such as the Model Law, provided that those standards ensure a prudentially sound legal regime for extending credit through the banking system. For instance, the Basel framework may encourage States to reorder the nexus of preferential claims in order to render the techniques to manage credit risk more effective, thus supporting the implementation of the relevant article of the Model Law. Moreover, BCBS may indicate that only notice-based electronic registries satisfy the prudential requirements because of the lower level of legal risk and reduced costs, as compared to document-registration and paper-based systems. As a result, current gaps and grey areas would be clarified — promoting a more harmonious and coherent implementation of both secured transactions laws and capital requirements. Ultimately, the question of whether to amend some of the existing soft-law instruments should be explored with the intent of maximizing the impact and the effective implementation of the core legal components sustaining credit-based economies.

To reach this ambitious, yet attainable, goal there are two practical steps that could be taken. First, a dialogue between UNCITRAL, the BCBS, and other interested bodies should be established. The primary intent is to elucidate critical aspects of the interaction of the two areas of law, such as with regard to the standards for describing encumbered assets in security agreements and in respect to whether enforcement of security rights through authorities other than courts would satisfy the policy expectations pursued by the Basel framework. Within this dialogue, official inquiries should be conducted to reveal the extent to which the simultaneous application of a modern secured transactions regime and capital requirements affects the cost of credit and stimulates shadow banking activities.

To define an inter-institutional mechanism for cooperation, UNCITRAL's past and current experiences indicate a possible way forward. The UNCITRAL Secretariat has been traditionally keen to ensure coordination with existing legal texts and projects carried out by international and regional organizations. During its 49<sup>th</sup> Session, the Commission acknowledged these efforts, particularly the coordination with the World Bank, the European Commission, the International Institute for the Unification of Private Law (UNIDROIT), the Organization of American States (OAS), and the Asia-Pacific Economic Cooperation (APEC).<sup>35</sup> The Commission renewed the mandate of the Secretariat to continue its coordination activities, but also extended it to focus more on providing training and technical assistance.<sup>36</sup> The 49<sup>th</sup> Commission also considered a specific report on the coordination of the UNCITRAL Secretariat's activities in the area of security rights with various organizations.<sup>37</sup> Although at that time there was no reference to prudential regulation or capital requirements, the possibility of fostering coordination between UNCITRAL and BCBS is expressly mentioned in a note of the Secretariat presented to the Commission for its 50<sup>th</sup> Session.<sup>38</sup> In view of this explicit novel interest, a dialogue with prudential regulators could start by following the mechanism deployed, in the field of security rights, to coordinate the activities of UNCITRAL, the Hague Conference on Private International Law, and UNIDROIT.<sup>39</sup> To this end, meetings were held (in 2008 and in 2009) between the aforementioned multilateral institutions to: (i) assure the

<sup>35</sup> UNCITRAL, 49<sup>th</sup> Commission Report, para. 126.

<sup>36</sup> *Ibid.*, para. 127.

<sup>37</sup> United Nations General Assembly, UNCITRAL Coordination Activities (A/CN.9/875) 10-11.

<sup>38</sup> United Nations General Assembly, UNCITRAL Possible Future Legislative Work on Security Interests and Related Topics (A/CN.9/913) 8. The note of the UNCITRAL Secretariat reflects the discussion held during the Fourth International Colloquium on Secured Transactions (Vienna, 15-17 March 2017) organized with the purpose of gathering views and advice concerning possible future work on secured transactions law. The program of the Colloquium is available here: < <http://www.uncitral.org/uncitral/en/commission/colloquia/4thint.html> > accessed 20 June 2017.

<sup>39</sup> See UNCITRAL, Hague Conference and UNIDROIT, Texts on Security Interests: Comparison and Analysis of Major Features of International Instruments Relating to Secured Transactions (United Nations, May 2012) < [http://www.uncitral.org/uncitral/en/uncitral\\_texts/security/2011UNCITRAL\\_HCCH\\_Unidroit\\_texts.html](http://www.uncitral.org/uncitral/en/uncitral_texts/security/2011UNCITRAL_HCCH_Unidroit_texts.html) > accessed 20 June 2017.

coherence of the substantive terms of the instruments that they sponsor; and (ii) avoid overlap and inconsistency among activities and instruments.<sup>40</sup>

A second essential step that UNCITRAL can immediately undertake is to prepare a Guide for States that decide to implement the Model Law. The proposed Guide should set out how a legal regime for secured transactions should be modernized in line with the policy objectives of prudential regulation and the specificities of capital requirements. To this end, the Guide should include specific recommendations for adapting domestic legislative and regulatory frameworks to international legal standards. In particular, it should illustrate to national law reformers and regulators how to assist their domestic banking industry to meet the conditions for tangible and intangible assets to be considered as valid credit protections, such as by providing a list of eligible collateral, by incentivizing the creation of secondary markets, and by determining what kind of non-eligible collateral could be used to calculate capital charges for loans that are past due, or non-performing. The Guide would have utility beyond the projects aimed at implementing the Model Law, as it could be equally useful for those economies that have opted to follow different models, such as the model laws developed by the Organization of American States and the European Bank for Reconstruction and Development.

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<sup>40</sup> Ibid., 1.

## *A Review of Security Rights Over Movable Property in Namibia*

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### *Introduction*

Security is important because it allows persons to access credit from financial institutions. Real security is the security a creditor may acquire by exercising a limited real right over a thing owned by the debtor to enforce payment by the debtor. Real security is, for instance, created by mortgage over immovable property and pledge over a movable thing.<sup>1</sup>

Security rights over non-possessory movable assets, is unrecognized and unregulated in Namibia. It is this gap that creates a barrier to Small and Medium Enterprises (SMEs) that are in need of access to credit and where the only property they have is movable, and where such property cannot be possessed by the credit grantor.

This article argues for legal reform and development to allow improved access to credit for the benefit of the Namibian economy. It considers the UNCITRAL Legislative Guide on Secured Transactions a vital key to assist Namibia in the development of an effective legal framework for security interests over movable property.

### *The Current Position in Namibia*

Mortgage bonds, notarial bonds, pledges and cession are the most common types of security over movable property in Namibia.<sup>2</sup> These forms of security, although recognized in our law do not all allow for non-possessory security rights.

Section 50(5) of the Deeds Registries Act, 1937 (Act No. 47 of 1937) provides that debts and obligations owing to various creditors and arising from different causes of action may not be secured by one mortgage bond. This poses an additional barrier to debtors who are unable to register multiple bonds owing to the various creditors that they may owe.

Notarial bonds also provide a favoured sense of security because a creditor may register the notarial bond over the movable property with the Registrar of Deeds in terms of sections 61-62 of the Deeds Registries Act, 1937. The registration of this bond does not automatically dispossess the property from the debtor. There is no perfect security prior to insolvency or default, and at the point of insolvency there is no payment of security unless the creditor is in possession of the movable asset. The creditor may however, in the event of default on the part of the debtor, apply to the High Court for possession of the movable assets.

Creditors would prefer to enter into pledge agreements with debtors, allowing them to take possession of the movable property to perfect security. However, taking possession of the property may not always be possible due to the nature of the property and the reality of the debtor to part with the property.

The Namibian High Court correctly reflects the Namibian position as it is today in *Commercial Bank of Namibia Limited v Rossing Stone Crushers* as follows:<sup>3</sup>

“Applicant as bondholder is not a secured creditor in the event of the insolvency of the respondent, and is entitled only to a preference over the concurrent creditors of the respondent with respect to the proceeds of assets subject to the bond in so far as they fall into the free residue of the estate. Should applicant however be able to take possession of the bonded property prior to the insolvency of the respondent it will have a secured claim as it then holds the property subject to a pledge.”

<sup>1</sup> Amoo S.K. *Property Law in Namibia*. 2014. Pretoria: Pretoria University Law Press. p. 13.

<sup>2</sup> LEXAfrica. *Insolvency and Restructuring Guide for Africa 2015*. P.70.

<sup>3</sup> Case No. A 40/93 heard by Frank J in the High Court of Namibia on 10 March 1993.

This is the reason why lenders and particularly commercial banks in Namibia, are unwilling to provide credit where the only available asset is movable. Consequently, the availability of credit particularly to SMEs is limited. In the absence of possession of the movable asset in order to perfect security other types of security over movable assets are neglected and lenders are better off being pledgees than in a position of bondholders.

The resulting lesson for Namibia is that there is a clear need to register security interests over movable property. The benefit of registration is two-fold firstly, it will create a secured claim for the holder of the security; and secondly, it will provide certainty about the assets encumbered. The registration of the security interests over movable property will therefore result in the validation and recognition of non-possessory security over movable assets, allowing for lenders to provide credit to persons and, especially SMEs who can only provide security in the form of movable assets.

This article proposes a fair consideration of the international best practices, and particularly the UNCITRAL Legislative Guide on Secured Transactions, in developing the relevant legislative framework for Namibia. This article maintains further that the UNCITRAL Guide on the Implementation of a Security Rights Registry will provide the urgently needed guidance to Namibia with respect to the establishment and operation of security rights registries<sup>4</sup> and that the provisions of these two UNCITRAL Guides should form part of the domestic legislation.

### *Conclusion and Recommendations*

The Namibian courts have already pointed out that the fact that the bondholder over specific movables may be in an even a worse position points to a need for law reform in this area.

This means that Namibia needs to undertake the task of recognizing and developing a legal framework for security rights over non-possessory movable property. The legal reform must consider the specific types of movable assets recognized as registrable, the appropriate legislation for the registration of rights over movable property, and how this reform impacts the Deeds Registries Act, 1937 and the manner in which commercial institutions currently grant credit.

There will be a need to determine a broad scope of the type of entities or institutions that can take a secure interest over the identified movable asset. The registration of security interests over movable assets will need to define the kinds of transactions that can benefit from the registration of such interests. By effecting this legislative reform, Namibia will be furthering its Constitutional objective to secure economic growth, prosperity and life of human dignity for all Namibians as provided under Article 98 of the Namibian Constitution. It is the duty of the State to establish a financial and legal framework that understands and addresses the barriers to access to finance.<sup>5</sup>

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<sup>4</sup> The Law Reform and Development Commission of Namibia. *Discussion Paper on Issues relating to the Insolvency Act, 1936 (Act No. 24 of 1936)*. 2015. p. 62-63.

<sup>5</sup> Ibid.

# *The Role of Model Law in Modernizing National Laws on Secured Transactions - In context of Chinese law*

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## *I. Introduction*

The United Nations Commission on International Trade Law (UNCITRAL) will celebrate its 50<sup>th</sup> anniversary. In the past 50 years, UNCITRAL has made a great contribution to the harmonization of international trade law. Among these numerous advances achieved by UNCITRAL are the removals of legal barriers and the creation of an efficient as well as a transparent legal environment, both of which have greatly enhanced the development of international business. Moreover, UNCITRAL serves as a platform for bringing us together.

For Chinese legal researchers, practitioners and students, another function of UNCITRAL is even more impressive and influential than those mentioned above — UNCITRAL provides us with valuable, practical and high-quality reference tools with which to modernize our national laws. A good example is the CISG convention, which serves as a model for the codification of Chinese Contract Law. <sup>1</sup>This paper intends to examine the potential contribution UNCITRAL can make in another working field — that of secured transactions.<sup>2</sup>

In 2016, UNCITRAL published the Model Law on Secured Transactions (ST Model Law). In the meantime, Chinese authorities have been engaged in drafting the Chinese civil code. This development presents a good opportunity to review the current Chinese laws with reference to the ST Model Law and the previous UNCITRAL Legislative Guide on Secured Transactions (ST Guide). However, as it is impossible to accomplish such a massive task, this paper will present a brief snapshot of the problems faced by the Chinese regime of secured transactions and will examine how ST Model Law and ST Guide fit into the Chinese context generally.

## *II. The Approach to Secured Transactions*

### *A. Chinese law: the formal approach*

The starting point of our examination is to understand that the Chinese regime is comprised of both the Chinese security law (CSL)<sup>3</sup> and the Chinese property law (CPL)<sup>4</sup>, along with a number of judicial interpretations and administrative rules. Normally, Title 4: Security Rights of CPL is more commonly used than CSL in secured transactions owing to the fact that CSL was enacted in 1995 whereas CPL came into force in 2007. In light of the dramatically fast pace of development of Chinese society, it is not difficult to understand why some articles of CSL cannot meet the demands of economics. As article 178 of CPL states, in case of any inconsistencies between the provisions of CSL and of CPL, CPL shall prevail. Generally, no matter whether we apply CPL or CSL, they all adopt the traditional formal approach.

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<sup>1</sup> Liming WANG: 'The United Nations Convention on Contracts for the International Sale of Goods and China's Contract Law', in *Thirty-five Years of Uniform Sales Law: Trends and Perspectives, Proceedings of the High Level Panel held during the Forty-eighth Session of the United Nations Commission on International Trade Law*, Vienna, 6 July 2015.

<sup>2</sup> Working Group VI was entrusted with the work on security interests in UNCITRAL's 56<sup>th</sup> session in 2001 (A/56/17 paras. 351 and 358). The most significant work products of Working Group VI are the *Legislative Guide on Secured Transactions* and the *Model Law on Secured Transactions*.

<sup>3</sup> Translation of CSL, see [http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content\\_1383719.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383719.htm).

<sup>4</sup> Translation of CPL, see [http://www.npc.gov.cn/englishnpc/Law/2009-02/20/content\\_1471118.htm](http://www.npc.gov.cn/englishnpc/Law/2009-02/20/content_1471118.htm).

## 1. Three devices for secured transactions and their scopes

As in most civil law jurisdictions, numerous *clausus* is established as a fundamental principle in CPL. According to article 5 CPL, the types and contents of proprietary rights shall be determined by law.<sup>5</sup> There are three forms of security rights provided by CPL: mortgage, pledge and lien. The nature of a lien here is “possessory”, as a method of self-act, rather than a consensual arrangement, so it will not be discussed in this paper.

A mortgage is characterized as a non-possessory security in CPL.<sup>6</sup> All movable assets, as long as they have not been prohibited from being mortgaged by laws or administrative regulations can be covered by the mortgage.<sup>7</sup> There is no limitation on the parties to a transaction as to the types of transactions and the obligations secured. However, the floating mortgage is an exception in that it has a limited scope: i.e., the assets covered are limited to four types, which are shown in the following diagram; only enterprise, individual business and agricultural can make such arrangement.<sup>8</sup>

CPL defines a pledge of movables as a possessory security. There is no restriction on the scope of a pledge, and the same with a mortgage. To relieve the inconveniences in trade caused by the traditional possessory method and as a response to practical demands,<sup>9</sup> CPL further develops the pledge of rights, especially as regards the receivables.<sup>10</sup> The scope of the encumbered assets covered by the security rights in CPL is comprehensive, which can be viewed in this diagram:

Forms of rights	Mortgage of movables	Floating mortgage	Pledge of rights	Pledge of movables
Assets covered	A. Equipment; Raw materials; Semi-finished products; Finished products. B. Vehicles C. Vessels and aircraft under construction. D. Any other asset that is not prohibited from being mortgaged by law or administrative regulations.	Current and future equipment, raw materials, semi-finished products, finished products	Any movable that is not prohibited from being pledged by law or administrative regulations.	A. Bills of exchange; Cheques; Promissory notes B. Bonds; Certificates of deposit C. Warehouse receipts; Bills of lading D. Transferrable fund units E. Intellectual property rights F. Receivables G. Other property rights which may be pledged as provided for by laws and administrative

## 2. Other security arrangements

<sup>5</sup> As a traditional and fundamental principle in civil law, the numerous *clausus* was introduced into CPL without argument. In recent years, this principle is being challenged in academy. See Yeong-Chin, Su, *In Search of New Civil Code* (PKU Press, Beijing, 2012), 117-227; Tze-Shiou, Chien, *Economic Reasoning and the Law* (Angle publishing, Taipei, 2014), 79-101; Jer-Shenq, Shieh, *Property Law* (Sanmin, Taipei, 2012), 49-52.

<sup>6</sup> The “mortgage” defined in article 179, CPL is fundamentally different with other jurisdictions. It is more similar to the “charge” in English law. See L. Gullifer, *Goode on Legal Problems of Credit and Security* (Sweet&Maxwell, London, 2013) para. 1-47.

<sup>7</sup> Article 180, CPL.

<sup>8</sup> Article 181, CPL.

<sup>9</sup> Liming Wang, *Research on Property Law* (RUP, Beijing, 2013), 568.

<sup>10</sup> Though it is controversial in academy, the Supreme Court held “The pledge of receivables not only consists with the international commercial practice, it creates a new path for security, which will have significant impacts on Chinese economics”. See The research group of property law, Supreme People’s Court, *The interpretation and application of property law* (PCP, Beijing, 2007), 670-672.

Although the CPL follows a relatively comprehensive approach which can cover a large array of assets, the *use of title* — including the transfer of title and the retention of title — and the *use of contract* — such as financial leases, sale and resale or sale and leaseback for security purposes — are still very common in Chinese financial practice.

In terms of security over specific movables, those arrangements are usually more practical and safer than choosing devices provided by CPL. This is because they are convenient, low cost as regards legal procedures, low risk in terms of their enforcement and, more significantly, give more consideration to the economic demands of the parties. By contrast, the mortgage registration of movables is complicated, sometimes even impossible, as will be discussed later. The use of pledge will prevent pledger from using them, which is uneconomic and hinders the flow of business.

Chinese law is at the crossroads of how these two arrangements can be characterized. Some arrangements have been affirmed by other laws: for example, with the retention of title, Chinese contract law (CCL) has demonstrated its effectiveness.<sup>11</sup> According to article 134 CCL, parties of a contract for sale can make an agreement that the ownership of goods will still belong to the seller if the buyer does not pay or perform other duties. With respect to financial leases, CCL sets out a section (from article 237 to 250) specially dealing with these and confirms that without an opposite agreement, the lender has complete ownership (not priority) of the leasehold during the lease term.

However, Chinese courts sometimes carry out re-characterization for reasons of functionality. In its judicial rules relating to private loans, the Supreme Court re-characterizes the contract of sale for securing the loan as the loan contract. Therefore, the lender cannot claim for the borrower to transfer the title of the asset to secure the loan.<sup>12</sup>

In contrast, with regards to the transfer of title of movables, Chinese courts are reluctant to make such a re-characterization for three reasons. The first is that CPL is a piece of legislation following the formal approach and if courts characterize the transfer of title as a security, they have to go a step further to determine which category (mortgage or pledge) it falls into to ascertain which part of CPL applies.<sup>13</sup> The second is that transferring the title of movables does not require registration in most cases and sometimes can be realized by virtual delivery, which cannot fulfil the requirement of publicity of security rights.<sup>14</sup> Such a re-characterization would indirectly deny any proprietary encumbrance imposed by the transfer of title. The third is that CPL prohibits any pre-contractual agreements being made before the enforcement of the security rights which would have the effect of automatically transferring title to the creditor if the obligation were not performed on time.<sup>15</sup> Transfer of title, once re-characterized as a security right, would contravene that prohibition. The basic policy underlying those three reasons is respect for common practices in business and the desire to adjust the rigid regime to accommodate credit demands. As a result, the transferee of the title has absolute ownership, a “super-priority” from a functional point of view.<sup>16</sup>

In summary, though CPL takes a formal approach, in financial practice the approach is always functional. As new and ever-more complex forms of secured transactions continue emerge, courts are faced with the task of resolving disputes arising from these developments. Furthermore, without integrated criteria, secured transactions in different forms, though with the same purpose, would be reviewed

<sup>11</sup> Translation of CCL, see [http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content\\_1383564.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383564.htm).

<sup>12</sup> Article 24, The Supreme People’s Court’s Interpretation of Private Loan.

<sup>13</sup> That is also the difficulty Chinese courts faced in characterising the new types of security. See the second tribunal for civil cases, Supreme People’s Court, *The Judicial Guidance of Security Cases* (Law Press, Beijing, 2014), 36.

<sup>14</sup> Lacking publicity is an important ground for the opinion that the new types of security should not be recognized as proprietary by courts. *ibid.* 36.

<sup>15</sup> Articles 186 and 211, CPL; Office of Civil Law, Commission of Legislative Affairs, Standing Committee of the National People’s Congress, *The clause explanations, legislative reasons and related rules of P.R.C property law* (PKU Press, Beijing, 2007), 340-341.

<sup>16</sup> Financial institutions, courts and related parties all tend to not deny the effectiveness of new types security based on the transfer of title or contractual arrangements. *Supra note* 13, 34-35; Lixin Yang: “A forming atypical security in customary law”, *China Legal Science*, 2013-3, 74-84.

separately in law and cause substantial unfairness. “Re-characterization” is not a technical difficulty for Chinese courts. But the premise to make re-characterization is other arrangements for security can also be placed in a frame to ensure their publicity, priority and enforcement without discrimination.<sup>17</sup>

*B. Solution given by UNCITRAL: A Unitary, functional and comprehensive approach*

The fragmentation of secured transactions law into multiple and often outdated laws dealing differently with the transactions that fulfil security functions, and the resulting gaps and inconsistencies, are the common concern for the regimes taking a formal approach.<sup>18</sup>

The solution UNCITRAL gives is a unitary, functional and comprehensive ST Model Law. “Unitary” means there is one integrated concept for all types of security interest, while “functional” means substance must prevail over form and the Model Law applies to all types of transaction that fulfil security purposes.<sup>19</sup> Finally, “comprehensive” means the Model Law applies to all types of assets, secured obligations, borrowers and lenders.<sup>20</sup>

There are six grounds given by the ST Guide for such an approach, which appear to be convincing:

- An integrated legal statutes and security rights enhance comprehensiveness, consistency and transparency.
- A functional approach covering the possessory security rights will help to modernize them.
- Re-characterizing the title finance will balance the interests of creditors and grantors.
- Covering contractual arrangements with security functions will minimize conflict and confusion as to the priority of the rights of the different creditors involved.
- A comprehensive regime places all security arrangements in a fair and competitive order of priority.
- An integrated security right can lower the overall cost of secured credit.<sup>21</sup>

What are the obstacles to taking such an approach in Chinese law? The traditional civil law theory we follow may play a major role. The ST Model Law reviews and strikes at this traditional frame and its principles and concepts, taking a functional approach, while we may be reluctant to change those theoretical presuppositions to which we have grown accustomed. The problem is whether in a fast-growing market-oriented society it is still possible or justified for civil law to hold on the old way and refuse to respond the need for a modern regime on the basis of those traditional presuppositions?

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<sup>17</sup> Same opinion, see Xueli Dong: ‘The Unification of Chinese Consensual Movables’ Security’, *The Chinese Journal of Law*, 2014-6, 113-115.

<sup>18</sup> S. V. Bazinas: ‘The draft UNCITRAL Model Law on secured transactions’, UNCITRAL library (65366), 24.

<sup>19</sup> See M. Bridge: ‘Secured Credit Legislation: Functionalism or Transactional Co-Existence’, UNCITRAL library (43205).

<sup>20</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/security/2016Model\\_secured.html](http://www.uncitral.org/uncitral/en/uncitral_texts/security/2016Model_secured.html).

<sup>21</sup> ST Guide, chapter I, paragraph 105. These grounds also explain the remarkably worldwide development of the functionalism and PPSAs, See L. Gullifer: ‘Personal property security law: where next? (part 2)’, *Law and Financial Markets Review* 2012, 541-546.



### III. The Creation and Third-party Effectiveness of Security Rights

#### A. Chinese law: no strict distinction

Chinese law distinguishes the effectiveness of security rights from the effectiveness of security contracts, rather than setting a clear and strict distinction between the creation and third-party effectiveness of security rights due to the principle that proprietary rights shall be absolute.

It has taken a long time for Chinese law to gradually admit the independence of the security contract from the security right. Before CPL, article 41 of CSL stipulated that if registration is required, the security contract shall come into force only when the registration has been completed, which gives rise to a very strong control over party autonomy — i.e. “no registration, no effective contract at all”. The adverse consequences of this subsequently came to the fore: when the mortgagor declines to register, the mortgagee cannot ask him to do so because their security contract is not effective as a legal ground.<sup>22</sup> In 2000, the Supreme Court made a technical adjustment in its interpretation of CSL. Article 56, paragraph 2 provided that when the security contract had been concluded but was not registered to come into force, the mortgagor declining to register contrary to good faith shall nonetheless be liable for the losses of the mortgagee.

There are separate rules for security contracts from those for the effectiveness of security rights. For security contracts, the only requirement as to formality is that it must be in written form. The contents of contract are decided by parties and normally include the form and amount of the secured obligation, the deadline for performance, the details of the encumbered assets and the scope of security.<sup>23</sup>

However, influenced by the principle of numerous clausus, CPL does not regard the security contract as an instrument of creating security rights. The only exception to this is mortgages of movables. In that case, the security would be created once the contract was concluded. In other circumstances, the creation of security rights cannot be accomplished by the contract, causing some inconsistencies.

Security Rights	Mortgage of Immovables	Mortgage of Movables	Pledge of Movables	Pledge of Rights
Creation	Registration	Conclusion of contract	Delivery	Delivery/registration
Perfection	Idem	Registration	Idem	Idem

#### B. UNCITRAL's attitude: a fundamental policy

As indicated in the ST Guide, UNCITRAL regards “distinguishing effectiveness as between the parties from effectiveness against third parties” as a fundamental policy of an effective and efficient secured transaction regime.

The main ground for taking such a position as provided by the ST Guide is the avoidance of additional formalities in the creation of security rights (even as between the grantor and secured creditor) that go well beyond what is normally required for contracting.<sup>24</sup>

Similarly, the ST Model Law insists that a security agreement is sufficient to create a security right.<sup>25</sup> Chapter II: Creation of a security right mainly deals with the scope of securities, the security agreement and extinguishment. Chapter III: Effectiveness of a security right against third parties involves the methods of archiving third-party effectiveness and the proceeds of them.

<sup>22</sup> Jiaan Liu, *Property Law* (CUPL Press, Beijing, 2015), 165-168.

<sup>23</sup> Articles 185 and 210, CPL.

<sup>24</sup> ST Guide, chapter II, paragraph 6.

<sup>25</sup> *Supra* note 18, 26.

CPL	UNCITRAL Model Law
Mortgage of movables: <b>Creation=Effectiveness of contract</b>	<b>Creation=Effectiveness of contract</b>
Other security rights: <b>Creation=Third-party effectiveness</b>	

Hence, by distinguishing between creation and third-party effectiveness, the ST Model Law simplifies the creation of security and ensures the value of party autonomy. In addition, the distinction works well from a structural design point of view, enabling the issues Model Law has to deal with to be laid out in a more clear, concise and consistent manner.

#### IV. The Registry System

##### A. Mortgage of movables: new changes

As previously mentioned, mortgage of movables in CPL can cover nearly all kinds of assets provided that it does not contravene any laws or administrative regulations. However, the comprehensive scope devised by CPL cannot be realized in practice due to the lack of an effective system of registration. Though CPL empowers the administrative departments of industry and commerce (AIC) to act as the registration authority as regards mortgages of existing and future equipment, raw materials, semi-finished products and inventory to facilitate corporate finance, especially for the small and medium sized enterprises, the registry system does not function well, further intensifying the difficulties in credit and stimulating the development of the title-based finance.

This ineffectiveness can be attributed to several factors. To begin with, the scope of registration was so limited and vague that AIC often declined to register assets other than the four types listed and business bodies not referred to in CPL. Secondly, the registration process was complex and costly, requiring the submission of contracts and other proofs, and thirdly the registry record was paper-based and difficult to search. What is more, there was no inter-area data system, and as a result inquiries could only be made on-the-spot at the AIC of the place where mortgagor located, leading to poor publicity on a national scale and difficulty in determining the order of priority.<sup>26</sup> As a result, banks tightened their lending standards given the high risk of credit exposure and often asked for securities over immovables.

In August 7, 2014, Premier Keqiang Li issued the order of the State Council to publish the Interim Regulation on Enterprise Information Disclosure. Article 6 of the regulation states: “Administrative departments for industry and commerce shall, through the Enterprise Credit Information Disclosure System, publicize the following enterprise information generated during the performance of their functions:

...

(2) Registration information of movable mortgages.

(3) Registration information of equity pledges”

The new regulation, by the use of the electronic disclosure system, immediately promotes the publicity of registration and spurs the State Administration for Industry and Commerce (SAIC) to revise its methods in relation to mortgages over movables. However, it is still very far from an integrated electronic registration system for notice registration as proposed by the ST Guide and ST Model Law.

##### B. Calling for a unified registration system in Chinese practice

The registration system of security rights in China is very diffuse. We not only set out different types of registration in light of the several forms of security rights, even within the same category, we require

<sup>26</sup> Shengping Gao: ‘The legal theory of the registration of movables mortgage’, Legal Science, 2016-2, 15.

registration with different authorities with distinct procedures and rules, depending on the nature and use of assets, or the identification of parties.

The pledge of rights can serve as a good example. The different registration systems set up by CPL are summarized as follows. Besides these registries, it is still possible to make a registration in the notary office.

Types of rights	Registry		Specification
<b>Negotiable Instruments</b>	With document of title	Delivery	
	Without document of title	Registration in related departments (Not clear)	Not Known
<b>Fund Units Securities</b>	Fund Units & Securities registered in “CSDC”	China Securities Depository and Clearing Corporation Limited “CSDC”	Detailed rules for the pledge registration of securities
	Securities not registered in “CSDC”	State and local administrative departments of industry and commerce “SAIC”	Measures for the pledge registration of securities at administrative departments for industry and commerce
<b>Trademarks</b>	Trademark Office, SAIC		Provisions on the procedures for the pledge registration of exclusive rights to registered trademarks
<b>Patents</b>	State Intellectual Property Office		Measures for the pledge registration of patents
<b>Copyrights</b>	National Copyright Administration		Measures for the pledge registration of copyrights

Such fragmentation has artificially increased the cost and risk of credit. It not only wastes time and resources of both parties, it also cannot ensure nationwide publicity or the order of priority. The unified registry itself is a process of resource integration — once it succeeds, all assets can be connected in relation to the credit, which would be on an almost infinite scale and fundamentally prevent loan fraud.<sup>27</sup>

### C. *What changes UNCITRAL can bring — a successful experiment in China*

The ST Guide highlights the status of registration in the whole regime of secured transactions, as “[n]othing is more central to the realization of this goal than the establishment of a general, notice-based, registry system.”<sup>28</sup> The registry ST Guide envisages is a system functioning to make security interests effective against third parties, to serve as an information source for the public to search and to provide an objective basis for determining the priority of competing interests.

In line with the ST Guide, ST Model Law establishes a “single, central registry for registering all security rights in all types of movable asset” and provides a set of Model Registry Provisions (MP) to deal with “the registration of notices of security interests in a publicly accessible Registry”.<sup>29</sup> The supporting model provisions are set out in a considerably precise and detailed manner including the requirements and proceedings of registration and search, the errors and changes, and the organization and record of registry. Those provisions have much referential value because of their delicate and precise design. In addition, the

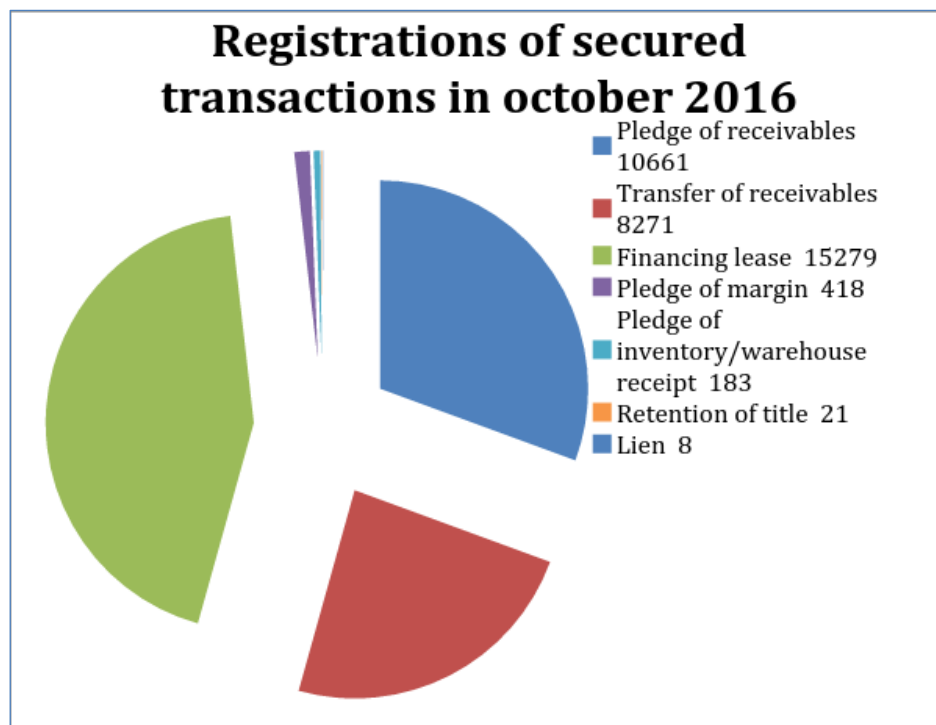
<sup>27</sup> The tardiness of the revolution of movables finance, Caixin Weekly, 2015-05.

<sup>28</sup> ST Guide, chapter IV, paragraph 1-8.

<sup>29</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/security/2016Model\\_secured.html](http://www.uncitral.org/uncitral/en/uncitral_texts/security/2016Model_secured.html).

notice registry,<sup>30</sup> the grantor's authorization,<sup>31</sup> the advance registration<sup>32</sup> and the one notice for multiple securities<sup>33</sup> work together to make the registry more convenient and low-cost.

In China, there is currently an effort to establish a unified registry for movables security made by The Credit Reference Centre, the People's Bank of China (CCRC). The CCRC is empowered by CPL as the registration authority for receivables. The registry for receivables gradually developed into the CCRC Movables Financing Registration.<sup>34</sup> The CCRC aims at establishing a comprehensive centralized registry for securities in all types of movable asset, which also includes the proprietary rights of which the movables consist. Even if the effectiveness of the CCRC's registration, except the pledge of receivables, has not been affirmed by CPL, and may face non-recognition in courts, it is still popular in practice. The figure below shows the types and amounts of registrations in October 2016.



Data Source: <http://www.zhongdengwang.org.cn/zhongdeng/2016/201612/d577b25f7a954abb80c6e701820b5bb8.shtml>

There are four characteristics of the CCRC's system which enable it to function efficiently and effectively, and which also make it more similar to the ST Model Law: the nationwide system of integrated registration records, the internet-based electronic registry, the notice of registration without the need to register the security contract, and formal review.<sup>35</sup> Small-and-medium sized businesses have benefited greatly from this registry due to its convenience, enabling them to obtain credit easier than before, which is shown in the following figure. That is exactly UNCITRAL aims to achieve.

<sup>30</sup> Model Registry Provisions (MP), C: Registration of a notice; H.C. Sigman: 'Some thoughts about registration with respect to security rights in movables', Uniform Law Review, 2010, 507-509.

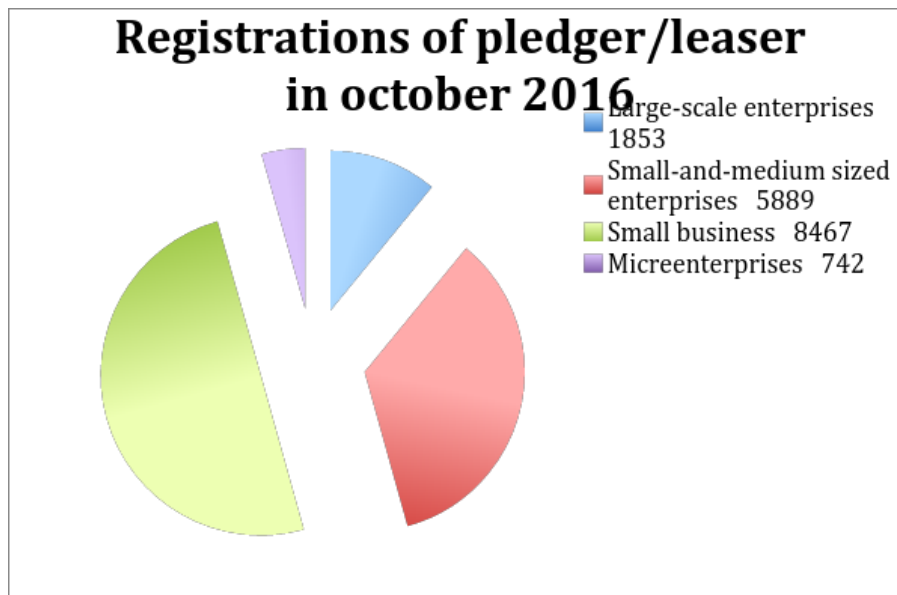
<sup>31</sup> Article 2, MP.

<sup>32</sup> Article 4, MP.

<sup>33</sup> Article 3, MP.

<sup>34</sup> The CCRC Movables Financing Registration System: <http://www.zhongdengwang.org.cn/zhongdeng/index.shtml>.

<sup>35</sup> The idea of CCRC's system, see: [http://www.zhongdengwang.org.cn/zhongdeng/djln/column\\_common.shtml](http://www.zhongdengwang.org.cn/zhongdeng/djln/column_common.shtml).



Data Source: <http://www.zhongdengwang.org.cn/zhongdeng/2016/201612/d577b25f7a954abb80c6e701820b5bb8.shtml>

In short, the CCRC's practice tells us the registry designed by the ST Model Law and ST Guide is workable, valuable and that there are no technical difficulties in adopting such a registry in China. It will be a practical scheme to further detail and normalize the CCRC's registry with the help of ST Model Law, to serve as a practical basis of the forthcoming reforms.

#### V. Priority

The rules of priority in Chinese law are not well-developed, as the concept of "priority" is not perceived in a unified way. In CPL, the term "priority" indicates the breakthrough of the principle of "equality among creditors" for secured creditors.<sup>36</sup> Another term, "liquidation order", is used by CPL to refer to the competition between mortgages. In Model Law, there is a unified concept of "priority" and a comprehensive set of priority rules to deal with the conflicts between a secured creditor and every possible competing claimant including other secured creditors, the transferees, lessees or licensees of the encumbered asset, the creditors with preferential claims and the creditor with a judgment.<sup>37</sup> This represents quite a significant difference between CPL and ST Model Law.

With regard to the priority between competing security rights, ST Model Law sets out a general principle-priority which is determined by the order of third-party effectiveness, giving first priority to whichever occurs first,<sup>38</sup> subject to several exceptions or additions for proceeds,<sup>39</sup> commingling,<sup>40</sup> acquisitions<sup>41</sup> and negotiable documents<sup>42</sup>. However, in CPL only the priority between mortgages is dealt in a similar way to the Model Law, based on the time of registration.<sup>43</sup> The Supreme Court in its interpretation of CSL stipulates that the registered mortgage will prevail over the perfected pledge, which appears to be very arbitrary.

<sup>36</sup> Article 170, CPL.

<sup>37</sup> Articles 34,36,37 ST Model Law; ST Guide, recommendations 79-84, chapter V, paragraph 11-15.

<sup>38</sup> Article 29, ST Model Law.

<sup>39</sup> Articles 32 and 41, ST Model Law.

<sup>40</sup> Article 33, ST Model Law.

<sup>41</sup> Articles 38-42, ST Model Law.

<sup>42</sup> ST Model Law, chapter V, B. asset-specific rules (except article 50 for intellectual property).

<sup>43</sup> Article 199, CPL.

The Model Law also resolves the potential conflict between secured creditors with the transferees, lessees or licensees of the encumbered asset, creditors with preferential claims and creditors with a judgment. In Chinese law, such rules are dispersed or even not provided for.

The comprehensive approach of the Model Law to priority rules can give prospective creditors and all related parties a much higher degree of certainty about the order of their interests and the resolution of their potential disputes compared with the current Chinese legal regime. This can in turn enhance credit, and in addition can ensure the smooth running of the ordinary course of business. Undoubtedly, it is a better scheme.

## *VI. Conclusion*

This paper has briefly discussed four fundamental policies of the UNCITRAL ST Model Law: the unitary, functional and comprehensive approach to secured transactions, the distinction between the creation and effectiveness of secured rights against third parties, the single, central registry for all security rights in all movable assets, and the comprehensive and precise rules of priority. In the context of Chinese law, those policies fit well into the fast-developing practices in secured transactions and give convincing answers to the existing problems in Chinese law, as analysed in this paper. Those policies should without doubt be used to guide the direction of reform, as they can respond to the demands of business, integrate scattered resources for credit and ultimately enhance the sustainable development of the economy.

Aside from the four fundamental policies, ST Model Law provides considerably more detailed and practical rules, which provide an all-encompassing and practical scheme to modernize Chinese law. Although it is impossible to review every detail of those rules from a Chinese perspective in such a short paper, undeniably, the ST Model Law, in combination with the ST Guide, IP Supplement and the Registry Guide, can function as a key reference tool for Chinese reform.

## Session 6 — Exit strategies and efficient and effective insolvency regimes

### *A Model-Law Approach to Sovereign Debt Restructuring*

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#### *Introduction*

Court decisions in the United Kingdom regarding the illegality of exit consents,<sup>1</sup> and in the United States regarding *pari passu* clauses in Argentine sovereign debt,<sup>2</sup> as well as the ongoing Greek debt saga and newly arising questions about Ghana, the Ukraine, Venezuela, and other countries, have dramatically highlighted the risks of an inadequate legal resolution framework for restructuring unsustainable sovereign debt. Even those who are not adherents of sovereign “bankruptcy” believe that the status quo contractual approach is “deeply dysfunctional and produces bad law.”<sup>3</sup> Unresolved sovereign debt problems are hurting individual debtor nations and their citizens, as well as their creditors,<sup>4</sup> and (as the United Nations Conference on Trade and Development has observed) are endangering the economic stability of many developing countries.<sup>5</sup> A sovereign debt default can also pose a serious systemic threat to the international financial system.<sup>6</sup>

<sup>1</sup> The Chancery Division of the English High Court held, in the *Anglo Irish* case Assénagon Asset Management S.A. v. Irish Bank Resolution Corporation Limited (formerly Anglo Irish Bank Corporation Limited) [2012] EWHC 2090 (Ch), that exit consents are illegal, casting doubt on the effectiveness of exit consents to restructure debt under English law. See, e.g., Patrick S. Kenadjian, *The Aggregation Clause in Euro Area Government Securities*, in COLLECTIVE ACTION CLAUSES AND THE RESTRUCTURING OF SOVEREIGN DEBT 143 (Patrick S. Kenadjian, Klaus-Albert Bauer & Andreas Cahn, ed. 2013) (observing that the judge in the *Anglo Irish* case “held that it was not lawful for the majority to aid in the coercion of a minority by voting for a resolution which expropriates the majority’s rights for nominal consideration[,] thus cast[ing] doubt on the legality under English law of any form of exit consent that imposes less favourable conditions on those who refuse to participate in the associated exchange offer.”).

<sup>2</sup> NML Capital, Ltd. v. Republic of Argentina, No. 08-CV-6978 TPG, 2012 WL 5895786 (S.D.N.Y. Nov. 21, 2012) (holding that the *pari passu* clause in Argentina’s defaulted bonds contract “prohibits Argentina, as bond issuer, from formally subordinating the bonds by issuing superior debt” and “prohibits Argentina, as bond payor, from paying [restructured] bonds without paying on the [holdout] Bonds”). Thus Argentina must pay all outstanding sums on its defaulted bonds simultaneously if it makes any payment on its restructured bonds. That decision was affirmed in its entirety by NML Capital, Ltd. v. Republic of Argentina, 727 F.3d 230 (2d Cir. 2013), cert. denied in Republic of Argentina v. NML Capital, Ltd., 134 S. Ct. 2819 (2014).

<sup>3</sup> Anna Gelper, *A Skeptic’s Case for Sovereign Bankruptcy*, in A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE? 262 (Christoph Paulus, ed. 2014).

<sup>4</sup> Cf. Joseph E. Stiglitz et al., *Frameworks for Sovereign Debt Restructuring*, IPD-CIGI-CGEG Policy Brief from a November 17, 2014 conference held at Columbia University, at 1 (stating that “[p]oorly designed arrangements for resolving sovereign debt problems can lead to inefficiencies and inequities ... Delays in restructuring can be very costly. Insufficiently deep restructuring can force the economy through multiple crises and restructuring—at a high cost.”).

<sup>5</sup> Statement of UNCTAD, Oct. 26, 2016 (also observing that unresolved sovereign debt problems “would thwart the 2030 Agenda for Sustainable Development before it had taken off”), available at [http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1364&Sitemap\\_x0020\\_Taxonomy=UNCTAD%20Home;#1705;#Debt and Development Finance;#1602;#Sovereign Debt Portal](http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1364&Sitemap_x0020_Taxonomy=UNCTAD%20Home;#1705;#Debt and Development Finance;#1602;#Sovereign Debt Portal).

<sup>6</sup> See, e.g., Jay L. Westbrook, *Sovereign Debt and Exclusions from Insolvency Proceedings*, in A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE?, at 251 (Christoph Paulus, ed. 2014). Cf. e-mail from Eva Hüpkens, Adviser on Regulatory Policy and Cooperation at the Financial Stability Board (FSB), to the author (July 14, 2015) (observing that “doubts about the ability of states to provide additional resources can make financial institutions more fragile, in particular where there are no regimes in place that provide authorities with powers and tools to resolve financial firms without use of public funds”).

## *The Contractual Approach Is Inadequate*

One of the main impediments is that the existing “contractual” approach to sovereign debt restructuring — the use of so-called collective action clauses (CACs) — is insufficient to solve the holdout problem. CACs are clauses in debt contracts that enable a specified supermajority, such as two-thirds or three-quarters, of the contracting parties to amend the principal amount, interest rate, maturities and other critical repayment terms. The holdout problem is a type of collective action problem in which certain creditors, such as vulture funds that may have bought debt in the secondary market at a deep discount, hope to extract value from other creditors to obtain more than their fair share of payment. They do this by litigating for payment and refusing to agree to a debt restructuring plan that would change critical terms, even though the other creditors consider the plan reasonable. Empirical research indeed shows “a drastic rise of sovereign debt litigation” by holdout creditors.<sup>7</sup>

CACs are insufficient for several reasons. Many sovereign debt contracts lack them, requiring unanimity to change critical repayment terms — and thus enabling any party to the contract to act as a holdout. For example, after years of trying to include CACs, relatively few Greek debt agreements actually contained such clauses and those that did were generally restricted to bond issues. Even in contracts that include CACs, the supermajority requirement may be so high (for example, three-quarters) that vulture funds are able to purchase vote-blocking positions that enable them to act as holdouts.

Furthermore, a CAC ordinarily binds only the parties to the particular contract that includes it. The parties to any given sovereign debt contract therefore could act as holdouts in a debt restructuring plan that requires all of a debtor-state’s debt issues to agree to the plan. Although in 2014 the International Capital Market Association (“ICMA”) proposed revised and updated forms of CACs that would aggregate voting across debt issues, the experience with standard CACs shows that many sovereign debt contracts will lack them. Moreover, even if all new sovereign debt contracts were to include aggregate-voting CACs, it will be many years before existing debt contracts, which do not include them, are paid off.<sup>8</sup>

CACs have been a step forward in some ways, but they are not a substitute for pursuing a more systematic legal resolution framework for helping debtor-states to restructure unsustainable debt. In the past, the International Monetary Fund (IMF) unsuccessfully proposed, and recently the General Assembly of the United Nations has voted to pursue, a treaty or convention that would govern sovereign debt restructuring.<sup>9</sup> The political economy of treaty-making, however, makes that type of multilateral approach highly unlikely to succeed in the near future.

## *Advantages of a Model-Law Approach*

A model-law approach to achieving a more systematic legal resolution framework should be legally, politically and economically feasible.<sup>10</sup> A model law is suggested legislation for national (and sometimes subnational) governments to consider enacting as internal law in their jurisdictions. Each government

<sup>7</sup> Julian Schumacher, Christoph Trebesch, & Henrik Enderlein, “Sovereign Defaults in Court” i (May 6, 2014 draft, available at <https://ssrn.com/abstract=2189997>). That research also suggests “that creditor litigation is increasingly common and costly for defaulting sovereigns”). *Id.* at 1.

<sup>8</sup> See, e.g., International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring* 33 (2014), available at <http://www.imf.org/external/pp/longres.aspx?id=4911> (observing that approximately 29% of all sovereign bonds outstanding, and approximately 39% of all such bonds governed by New York law, “will mature after ten years”).

<sup>9</sup> In 2014, the United Nations General Assembly voted to begin work on a statutory approach, referred to as a “multilateral legal framework,” for sovereign debt restructuring. The resolution was introduced by Bolivia on behalf of the Group of 77 developing nations (of which Bolivia was then the chair) and China. See <http://www.un.org/press/en/2014/gaef3417.doc.htm>. The United States and apparently the European Union opposes this approach. The United Nations Conference on Trade and Development (UNCTAD) has been tasked with moving this approach forward. There is skepticism, however, whether any formal framework, such as a convention, is feasible—at least in the near future—without U.S. and E.U. support.

<sup>10</sup> See also Steven L. Schwarcz, *Sovereign Debt Restructuring: A Model-Law Approach*, 6 JOURNAL OF GLOBALIZATION AND DEVELOPMENT 343 (2016).



enacting a model law should therefore take the steps necessary to make the law effective in its jurisdiction. To facilitate cross-border legal comparability, each government enacting a model law should, ideally, enact the same legislative text. For that reason, model laws are sometimes called uniform laws. The UNCITRAL Model Law on International Commercial Arbitration exemplifies a model law that has been uniformly enacted in an international context; the Uniform Commercial Code (UCC) in the United States exemplifies a model law that has been uniformly enacted in a subnational context.

The less formal process of developing and enacting a model law can be politically appealing. Indeed, adoption of the UNCITRAL Model Law on International Commercial Arbitration, in an area of law that had for many years struggled to realize reform, may have been successful, in part, due to its less formal structure as a model law. A model-law approach would not require general acceptance for its implementation. Nations and even subnational jurisdictions could individually enact a model law as their internal law.<sup>11</sup> Contracts governed by that law would thereby become governed by the model law. Choice of law thus gives a model-law approach a powerful multiplier effect.

### *A Proposed Model Law*

The Appendix to this article proposes a Sovereign Debt Restructuring Model Law.<sup>12</sup> Among other things, the proposed Model Law addresses the holdout problem by legally mandating supermajority voting that, assuming the requisite percentages agree, can bind holdout creditors.<sup>13</sup> It also enables a debtor-state to aggregate creditor voting beyond individual contracts. Aggregate voting is critical for at least two reasons: it can prevent creditors of individual sovereign debt contracts from acting as holdouts vis-à-vis other sovereign debt contracts; and it allows a debtor-state to designate large enough classes of claims to prevent vulture funds (or similar holdouts), as a practical matter, from purchasing enough claims to block a restructuring plan or otherwise control the voting.

The Model Law solves the problem of *pari passu* clauses.<sup>14</sup> *Pari passu* clauses currently in sovereign debt contracts (at least those governed by New York law, which are the majority) effectively require that payments to creditors under a given debt contract be made *pari passu* to all of that contract's creditors—even creditors who exchanged their original claims for debt claims under a new debt contract.<sup>15</sup> Say, for example, that a particular debt contract with Country X has three creditors—Creditor A with a claim of \$1,000, Creditor B with a claim of 2,000, and Creditor C with a claim of \$3,000. If Country X makes a \$1,000 payment on this debt, that payment must be shared equally and ratably (i.e., on a *pari passu* basis) among the three creditors. Thus, Creditor A would have the right to receive its ratable share (\$1,000/\$6,000, or one-sixth), Creditor B would have the right to receive its ratable share (\$2,000/\$6,000, or one-third), and Creditor C would have the right to receive its ratable share (\$3,000/\$6,000, or one-half), of that \$1,000 payment. Once sovereign debt claims are modified in accordance with the Model Law's supermajority aggregate voting, however, their principal amounts would, as so modified, legally change.

The Model Law also addresses the critical need for a financially troubled debtor-state to obtain liquidity during its restructuring process. Although this funding has in the past often been provided by the IMF, the IMF may be unable, or unwilling, to continue providing funding in the amounts needed.<sup>16</sup> Absent

<sup>11</sup> This is especially significant because, as explained below, most sovereign debt contracts are governed by either New York or English law. One or both of those jurisdictions — in the case of New York law, a subnational jurisdiction — could enact legislation based on a model law.

<sup>12</sup> Earlier versions of this Model Law have been vetted in discussions with working groups of the International Insolvency Institute (“III”) and the Centre for International Governance Innovation (“CIGI”). See *infra* note 34.

<sup>13</sup> This assumes, of course, that the claims of those holdout creditors are governed by the law of a jurisdiction that enacts the Model Law.

<sup>14</sup> See *supra* note 2 and accompanying text.

<sup>15</sup> Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, in 72 BIS PAPERS 121, 124-26 (discussing the meaning of the *pari passu* clause, in the sovereign debt context, in the *Blott* case in Belgium and the *Argentina* case in New York).

<sup>16</sup> Cf. Brad Setser, IPD Task Force on Sovereign Debt brief, *The Political Economy of the SDRM* 5 (Jan. 3, 2008), [http://www.cfr.org/content/publications/attachments/Setser\\_IPD\\_Debt\\_SDRM.pdf](http://www.cfr.org/content/publications/attachments/Setser_IPD_Debt_SDRM.pdf) (observing that “it is unrealistic for the major emerging economies to think that the IMF will prevent all default”).

the IMF, whose loans have de facto priority, no one would lend new money without obtaining a priority repayment claim. Unless (as in the case of Greece) virtually all of a debtor-state's indebtedness is held by a relatively small number of governmental organizations, it would be impractical to get the existing creditors to contractually subordinate their claims to the new money. The Model Law, however, gives such new-money lenders priority over existing creditors, provided existing creditors have notice and the opportunity to block the new lending if its amount is too high or its terms are inappropriate. (The Model Law does not, of course, prevent a debtor-state from also, or alternatively, obtaining such financing through a governmental or multi-governmental source, such as the IMF.)

The Model Law contemplates a "neutral international organization" as the law's supervisory authority. It is currently unclear what organization might qualify as truly neutral; existing organizations such as the IMF, the World Bank, or a court of the debtor-state may be considered too political or conflicted. That temporary lack of clarity should not be confused, however, with an unrelated issue that is inapplicable to the Model Law. Formal sovereign debt restructuring solutions, such as a treaty, are often conflated with broadly empowered supervisory bodies that exercise debt-restructuring discretion which can impinge on national sovereignty. In contrast, the supervisory authority under the Model Law lacks authority to exercise discretion. All disputes are adjudicated through binding arbitration. The main role of the supervisory authority is administrative and non-discretionary: to fact-check information, to maintain a list of creditors, and to oversee the creditor voting process.

As an option, the Model Law also includes retroactivity. Because most outstanding sovereign debt contracts (if not governed by the debtor-state's law) are governed by New York or English law,<sup>17</sup> enactment by those jurisdictions of the Model Law, with retroactivity, could greatly facilitate the restructuring of not only future but also existing sovereign debt contracts.

Although retroactive lawmaking is somewhat atypical, as a normative matter it would provide significant social benefit and little harm—and thus should be morally imperative. The significant social benefit would be the opportunity that a retroactive Model Law could provide to countries, whose outstanding debt is or becomes unsustainable, to try to renegotiate that debt to sustainable levels. Renegotiation could reduce economic hardship to innocent citizens and deprivation of essential government services,<sup>18</sup> forestall the likelihood of riots and other popular protests,<sup>19</sup> and reduce the potential for financial chaos resulting from a country's debt default.<sup>20</sup> At the same time, retroactivity would impose little harm. The only parties whose expectations would be impaired would be holdout creditors. But any such impairment would be limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors based on the debtor-state's deteriorating economic circumstances, and thus should reflect the economic reality—and therefore the reasonable expectations—of what those creditors expect to receive as payment under those changed circumstances.<sup>21</sup>

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<sup>17</sup> See e.g., Philip R. Wood, *Governing Law of Financial Contracts Generally*, in CONFLICT OF LAWS AND INTERNATIONAL FINANCE 12 (ed. 2007); Setser, *supra* note 16, at 16 (observing that "[a]lmost all international bonds are now governed by New York law, English law, and to a lesser extent Japanese law").

<sup>18</sup> See, e.g., Nick Robins-Early, *What's Behind the Economic Chaos in Venezuela*, June, 2016, available at [http://www.huffingtonpost.com/entry/venezuela-economic-crisis-explainer\\_us\\_57507abde4b0eb20fa0d2c54](http://www.huffingtonpost.com/entry/venezuela-economic-crisis-explainer_us_57507abde4b0eb20fa0d2c54); Lucy Rodgers & Nassos Stylianou, *How Bad are Things for the People of Greece?*, July, 2015, available at <http://www.bbc.com/news/world-europe-33507802>.

<sup>19</sup> See, e.g., Niki Kitsantonis & Rachel Donadio, *Greek Parliament Passes Austerity Plan After Riots Rage*, Feb. 12, 2012, available at <http://www.nytimes.com/2012/02/13/world/europe/greeks-pessimistic-in-anti-austerity-protests.html>.

<sup>20</sup> See, e.g., *Finding Solutions to the Debt Problems of Developing Countries*, Report of the Executive Committee on Economic and Social Affairs of the United Nations, May 1999, available at <http://www.cepal.org/publicaciones/xml/6/4306/lcl1230i.pdf>. Cf. James S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study on Relationship between The Fifth Amendment and The Bankruptcy Clause*, 96 HARV. L. REV. 973, 1016 (1983) (explaining the importance of retroactive bankruptcy legislation).

<sup>21</sup> Even if that impairs a holdout creditor's ability to blackmail a country's debt restructuring in order to extract value from the other creditors, that holdout behaviour would be morally repugnant.

As a legal matter, retroactivity is permitted under international law so long as it is neither discriminatory nor arbitrary. The Model Law's key operative provisions — supermajority aggregate voting, and the granting of priority to financiers of a debtor-state's debt restructuring — should be neither. Retroactivity is also permitted under English law.<sup>22</sup> Retroactivity might raise a controversial legal issue, however, for sovereign debt contracts governed by New York law.

The “Contracts Clause” of the US Constitution, in Article I, Section 10, prohibits states, such as New York (as opposed to the federal government), from enacting any legislation that impairs existing contractual obligations. Nonetheless, I have separately concluded that New York State should be able to frame its enactment of the Model Law in such a way as to not violate the Contracts Clause.<sup>23</sup> In general, a state has leeway to retroactively impair contracts if the impairment is reasonably necessary to further an important public purpose and also reasonable and appropriate to effectuate that purpose. This leeway may be even greater if the contractual impairment is not substantial. New York State could therefore frame enactment of the Model Law, with retroactivity, as an exercise of its police powers to reduce sovereign debt defaults that could lead to a systemic economic collapse, thereby protecting economic activity within its borders. The Model Law's supermajority aggregate voting and granting of priority to financiers of a debtor-state's debt restructuring are appropriately tailored to reduce that threat. Furthermore, as discussed above, any contractual impairment should not be “substantial,” being limited to changes that are voluntarily agreed to by a supermajority of *pari passu* creditors based on the debtor-state's deteriorating economic circumstances.<sup>24</sup>

### *Political Economy of the Model Law*

A final question is whether the Model Law would be economically and politically feasible. Some nations may be concerned, for example, that enactment of the Model Law might increase their borrowing costs by making creditor claims more subject to bail-in. Economists have recently argued and provided empirical evidence to the contrary — that uncertainty due to the absence of an effective sovereign debt resolution framework actually increases the costs of borrowing.<sup>25</sup> However, even if the Model Law would increase borrowing costs, it should not exceed the cost increase resulting from aggregate-voting CACs being included in all debt contracts, which has been the ideal goal of the contractual approach to sovereign debt restructuring.<sup>26</sup>

The Model Law should also be politically feasible. As mentioned, its less formal enactment process can be appealing to debtor-states. The Model Law would not require general acceptance by the world's nations for its implementation. Jurisdictions that are interested in becoming or continuing as global leaders in debt restructuring—especially those with a reputation in finance and the rule of law—should want to enact the Model Law, in order to persuade parties to choose their law to govern new debt issuances. Countries will want their debt to be governed by a law that solves the holdout problem. Investors will want the governing law not only to be that of a neutral jurisdiction but also to reduce uncertainty and disruptive litigation.

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<sup>22</sup> Steven L. Schwarcz, *Sovereign Debt Restructuring and English Governing Law*, BROOKLYN JOURNAL OF CORPORATE, FINANCIAL AND COMMERCIAL LAW (forthcoming 2017 symposium issue on “Public Bankruptcy”), available at <http://ssrn.com/abstract=2952776>.

<sup>23</sup> See *supra* note 10.

<sup>24</sup> See *supra* notes 20-21 and accompanying text. Cf. *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006) (“To assess whether an impairment is substantial,” a court should “look at ‘the extent to which reasonable expectations under the contract have been disrupted.’”) (quoting *Sanitation & Recycling Indus., Inc. v. City of New York*, 107 F.3d 985, 993 (2d Cir 1997)); Steven L. Schwarcz, *A Minimalist Approach to State ‘Bankruptcy’*, 59 UCLA L. REV. 322, 336-37 (2011) (advocating for a consensual debt restructuring process that enables states to seek relief from their unsustainable debt burdens and also protects creditor expectations—other than those of holdout creditors who are trying to extract value from others).

<sup>25</sup> Stiglitz et al., *supra* note 4, at 1.

<sup>26</sup> See text accompanying note 8, *supra*. The inclusion of those types of CACs is also part of the ninth goal of the UN's Basic Principles on Sovereign Debt Restructuring Processes, discussed below.

It is also informative to assess the Model Law's political feasibility from the perspective of the politics of the IMF's failed treaty approach. That approach failed for several reasons. Certain emerging market countries feared it would raise their cost of borrowing. As mentioned, however, the Model Law arguably should reduce or not affect that cost.<sup>27</sup> At the time the IMF proposed its treaty approach, many believed that exchange offers could solve the sovereign debt problem. Experience, however, has long since undermined that belief. Some also opposed the IMF's treaty approach because of suspicions about the IMF's conflicting role as both treaty sponsor and supervisory authority thereunder. The Model Law, in contrast, is not designed by the IMF, nor is the IMF part of its supervisory process. Furthermore, as indicated, the Model Law limits the supervisory process to non-discretionary administrative actions. Debtor-states should therefore want — and creditors, other than rent-seeking holdouts, should want them — to enact the Model Law.

### *The Model Law Embraces the UN's Basic Principles on Sovereign Debt Restructuring Processes*

The Model Law embraces these Basic Principles ("Principles"), adopted by the United Nations General Assembly in 2015.<sup>28</sup> The first Principle is that "A Sovereign State has the right ... to design its macroeconomic policy, including restructuring its sovereign debt ... Restructuring should ... preserv[e] at the outset creditors' rights." The Model Law may indeed be enacted, voluntarily, by any debtor-state. The very fact that it is a "model" law means that a debtor-state could modify its terms. The second Principle concerns good faith, holding that "Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations ... with the aim of a prompt and durable reestablishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms." The Model Law's Preamble states in relevant part that its purpose is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce the social costs of sovereign debt crises. Article 6 of the Model Law requires that the restructuring plan will enable the State's debt to become sustainable. The Model Law's supermajority voting requirement for restructuring also respects the need for a "critical mass of creditors" to support the restructuring terms.

Under the third Principle, "Transparency should be promoted in order to enhance the accountability of the actors concerned ... " The Model Law requires full transparency, including disclosure of any claims not included in the restructuring. The Model Law clearly embraces the fourth Principle ("Impartiality"), being completely impartial. The fifth Principle concerns equitable treatment: imposing on debtor-states "the duty to refrain from arbitrarily discriminating among creditors ... Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded ex ante from the sovereign debt restructuring process." The Model Law embraces this Principle by including all of a debtor-state's debt claims except for internal operational claims (such as pension and retiree obligations, tax refunds, unpaid salaries to public employees, and social program payments), and also by requiring pari passu claims to be treated alike or else giving their holders a supermajority-voting power to veto a restructuring. The Model Law at least de facto respects the sixth Principle, that "Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts ... ," by recognizing the reality that a creditor obtaining a foreign judgment against a debtor-state cannot use that judgment to attach sovereign assets within that state.<sup>29</sup>

The seventh Principle, "Legitimacy," "entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement." The Model Law fully respects legitimacy in all of these forms. The eighth Principle, "Sustainability," is one of the Model Law's primary goals. This Principle "implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a

<sup>27</sup> See *supra* note 25 and accompanying text.

<sup>28</sup> "Basic Principles on Sovereign Debt Restructuring Processes" (A/69/L.84), adopted by the General Assembly of the United Nations in New York at its Sixty-Ninth Session on 10 September 2015.

<sup>29</sup> For that reason, the Model Law does not include a stay.

stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights." The Model Law is designed to restructure unsustainable debt in order to achieve a stable debt situation. Its very Preamble explains that the Model Law will provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce the social costs of sovereign debt crises, systemic risk to the financial system, creditor uncertainty, and the need for sovereign debt bailouts, which are costly and create moral hazard.

The Model Law is explicitly designed to facilitate the ninth Principle, "Majority restructuring," which "implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be ... impeded by ... a non-representative minority of creditors ... States should be encouraged to include collective action clauses in their sovereign debt to be issued." The Model Law enables a specified majority of creditors, voting on an aggregate basis, to bind all *pari passu* creditors, thereby preventing vulture funds and other holdouts from impeding a debtor-State's debt restructuring. The Model Law also works in parallel with, and embraces, collective action clauses. A debtor-state could, for example, decide to exclude claims that incorporate collective action clauses from the Model Law's operation, so long as it discloses those excluded claims. Creditors on those claims also have the right, if they choose, to contractually opt into the Model Law's terms, conditions, and provisions.

### *Recommendations*

This article proposes a model-law approach to sovereign debt restructuring as a topic for UNCITRAL research. Such an approach would be modest, compared to a multilateral treaty; but the ability of debtor nations and their creditors to choose the model law to govern their debt contracts gives a model-law approach a powerful multiplier effect, and thus a significant potential impact. As a starting point, this article proposes the text of such a law (defined herein as the Model Law), which already has been vetted in discussions with leading experts worldwide.<sup>30</sup> That vetting also indicates that a model-law approach should have widespread acceptance.<sup>31</sup>

Even if it achieves nothing else, UNCITRAL's researching a model-law approach should provide incremental steps toward developing norms for a sovereign debt restructuring legal framework that goes beyond mere contracting. An incremental approach to developing norms has strong precedent in the legal ordering of international relationships,<sup>32</sup> especially "where law reformers possess limited authority and where the subject [like sovereign debt restructuring] is either controversial or technical."<sup>33</sup> A model law could also be pursued in parallel as part of a broader strategy for developing a legal resolution framework for sovereign debt restructuring.

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<sup>30</sup> See *supra* note 12 and accompanying text.

<sup>31</sup> Given that vetting, this article's Model Law should in principle be ready for enactment by interested jurisdictions, whether or not UNCITRAL selects this article's topic for further research.

<sup>32</sup> Cf. Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 UNIVERSITY OF CHICAGO LAW REVIEW 469, 531 (2005) (observing that "states can be gradually led toward stronger legal rules ... by starting with relatively weak international rules backed by little or no sanctions that all states feel comfortable joining, but then gradually pushing states to accept successively stronger and more challenging requirements").

<sup>33</sup> Susan Block-Lieb & Terence Halliday, *Incrementalisms in Global Lawmaking*, 32 BROOKLYN JOURNAL OF INTERNATIONAL LAW 851, 852 (2007). Cf. John A.E. Pottow, *Procedural Incrementalism: A Model for International Bankruptcy*, 45 VA. J. INT'L L. 935, 939 (2005) (observing that UNCITRAL's Model Law on Cross-Border Insolvency "created an opportunity to bridge the theoretical gap between universalists and territorialists ... by appearing to be a hybrid of universalism and territorialism[,] ... thus allow[ing] hesitant states to 'acclimate' to a regime of universalism"). An incremental approach to developing norms has also been valuable for addressing international environmental problems, such as climate change. See, e.g., DANIEL J. FIORINO, THE NEW ENVIRONMENTAL REGULATION 221 (2006) (arguing that "an incremental ... strategy for change offers the best alternative for speeding up the transition to a new environmental regulation").

## *Appendix*

### *Sovereign Debt Restructuring Model Law*<sup>34</sup>

#### *Preamble*

The Purpose of this Law is to provide effective mechanisms for restructuring unsustainable sovereign debt so as to reduce (a) the social costs of sovereign debt crises, (b) systemic risk to the financial system, (c) creditor uncertainty, and (d) the need for sovereign debt bailouts, which are costly and create moral hazard.

#### *Chapter I: Scope, and Use of Terms*

##### *Article 1: Scope*

- (1) This Law applies where, by contract or otherwise, (a) the law of [this jurisdiction<sup>35</sup>] governs the debtor-creditor relationship between a State and its creditors and (b) the application of this Law is invoked in accordance with Chapter II.
- (2) Where this Law applies, it [shall operate retroactively and, without limiting the foregoing,<sup>36</sup>] shall override any contractual provisions that are inconsistent with the provisions of this Law.

##### *Article 2: Use of Terms*

For purposes of this Law:

- (1) “creditor” means a person or entity that has a claim against a State;
- (2) “claim” means a payment claim against a State for monies borrowed or for the State’s guarantee of, or other contingent obligation on, monies borrowed; and the term “monies borrowed” shall include the following, whether or not it represents the borrowing of money per se: monies owing under bonds, debentures, notes, or similar instruments; monies owing for the deferred purchase price of property or services, other than trade accounts payable arising in the ordinary course of business; monies owing on capitalized lease obligations; monies owing on or with respect to letters of credit, bankers’ acceptances, or other extensions of credit; and monies owing on money-market instruments or instruments used to finance trade;
- (3) “Plan” means a debt restructuring plan contemplated by Chapter III;
- (4) “State” means a sovereign nation;
- (5) “Supervisory Authority” means [name of neutral international organization].

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<sup>34</sup> In writing this Model Law, the author benefited greatly from discussions with colleagues on the International Insolvency Institute (III) Working Group on Sovereign Insolvencies and the CIGI ILRP Working Group on Cross-Border and Sovereign Insolvencies. Besides the author, the members of these working groups are, respectively, Donald Bernstein, Zack Clement, Allan Gropper, Robin Itkin, Steven T. Kargman, Kenneth N. Klee, Christopher Klein, Bruce Leonard, Charles W. Mooney, Christoph Paulus and Ignacio Tirado; and Mona Davies, Oonagh Fitzgerald, Mark Jewett, Bruce Leonard, John Murray, Catherine Walsh and Miranda Xafa.

<sup>35</sup> This would refer to a jurisdiction enacting this Model Law, for example, New York, England, a nation, etc. Articles 3(3) and 12 further expand this Law’s application.

<sup>36</sup> This provision is optional. Retroactivity would be especially powerful if New York State or England enacts the Model Law. *See supra* notes 17-23 and accompanying text.

## *Chapter II: Invoking the Law's Application*

### *Article 3: Petition for Relief, and Recognition*

- (1) A State may invoke application of this Law by filing a voluntary petition for relief with the Supervisory Authority.
- (2) Such petition shall certify that the State (a) seeks relief under this Law, and has not previously sought relief under this Law (or under any other law that is substantially in the form of this Law) during the past [ten] years, (b) needs relief under this Law to restructure claims that, absent such relief, would constitute unsustainable debt of the State, (c) agrees to restructure those claims in accordance with this Law, (d) agrees to all other terms, conditions, and provisions of this Law, and (e) has duly enacted any national law needed to effectuate these agreements. If requested by the Supervisory Authority, such petition shall also attach documents and legal opinions evidencing compliance with clause (e).
- (3) Immediately after such a petition for relief has been filed, and so long as such filing has not been dismissed by the Supervisory Authority [or this jurisdiction] for lack of good faith, the terms, conditions, and provisions of this Law shall (a) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of [this jurisdiction]; (b) apply to the debtor-creditor relationship between the State and its creditors to the extent such relationship is governed by the law of another jurisdiction that has enacted law substantially in the form of this Law; and (c) be recognized in, and by, all other jurisdictions that have enacted law substantially in the form of this Law.

### *Article 4: Notification of Creditors*

- (1) Within 30 days after filing its petition for relief, the State shall notify all of its known creditors of its intention to negotiate a Plan under this Law.
- (2) The Supervisory Authority shall prepare and maintain a current list of creditors of the State for purposes of supervising voting under this Law.

## *Chapter III: Voting on a Debt Restructuring Plan*

### *Article 5: Submission of Plan*

- (1) The State may submit a Plan to its creditors at any time, and may submit alternative Plans from time to time.
- (2) No other person or entity may submit a Plan.

### *Article 6: Contents of Plan*

#### *A Plan shall*

- (1) designate classes of claims in accordance with Article 7(3);
- (2) specify the proposed treatment of each class of claims;
- (3) provide the same treatment for each claim of a particular class, unless the holder of a claim agrees to a less favourable treatment;
- (4) disclose any claims not included in the Plan's classes of claims;

- (5) provide adequate means for the plan's implementation including, with respect to any claims, curing or waiving any defaults or changing the maturity dates, principal amount, interest rate, or other terms or cancelling or modifying any liens or encumbrances; and
- (6) certify that, if the Plan becomes effective and binding on the State and its creditors under Article 7(1), the State's debt will become sustainable.

#### *Article 7: Voting on the Plan*

- (1) A Plan shall become effective and binding on the State and its creditors when it has been submitted by the State and agreed to by each class of such creditors' claims designated in the Plan under Article 6(1). Thereupon, the State shall be discharged from all claims included in those classes of claims, except as provided in the Plan.
- (2) A class of claims has agreed to a Plan if creditors holding at least [two-thirds] in amount and more than [one-half] in number of the claims of such class [voting on such Plan<sup>37</sup>] [entitled to vote on such Plan] agree to the Plan.
- (3) Each class of claims shall consist of claims against the State that are *pari passu* in priority, provided that (a) *pari passu* claims need not all be included in the same class, (b) claims of governmental or multi-governmental entities each shall be classed separately, and (c) claims that are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law shall not be classed with other claims.

#### *Chapter IV: Financing the Restructuring*

##### *Article 8: Terms of Lending*

- (1) Subject to the provisions of this Article 8, the State shall have the right to borrow money on such terms and conditions as it deems appropriate.
- (2) The State shall notify all of its known creditors of its intention to borrow under Article 8(1), the terms and conditions of the borrowing, and the proposed use of the loan proceeds. Such notice shall also direct those creditors to respond to the Supervisory Authority within 30 days, stating (a) whether they approve or disapprove of such loan, (b) the principal amount of their claims against the State, and (c) the principal amount of those claims that are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law.
- (3) Any such loan must be approved by creditors holding at least two-thirds in principal amount of the claims of creditors responding to the Supervisory Authority within that 30-day period.
- (4) In order for the priority of repayment (and corresponding subordination) under Article 9 to be effective, any such loan must additionally be approved by creditors holding at least two-thirds in principal amount of the "covered" claims of creditors responding to the Supervisory Authority within that 30-day period. Claims shall be deemed to be "covered" if they are governed by this Law or the law of another jurisdiction that has enacted law substantially in the form of this Law.

##### *Article 9: Priority of Repayment*

- (1) The State shall repay loans approved under Article 8 prior to paying any other claims.
- (2) The claims of creditors of the State are subordinated to the extent needed to effectuate the priority payment under this Article 9. Such claims are not subordinated for any other purpose.

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<sup>37</sup> The Plan can be more easily approved if this alternative is selected, but reliable notice to creditors then becomes more important.



- (3) The priority of repayment (and corresponding subordination) under this Article 9 is expressly subject to the approval by creditors under Article 8(4).

#### *Chapter V: Adjudication of Disputes*

##### *Article 10: Arbitration*

- (1) All disputes arising under this Law shall be resolved by binding arbitration before a panel of three arbitrators.
- (2) The arbitration shall be governed by [generally accepted international arbitration rules of (name of neutral international arbitration body)] [the rules of the International Centre for Settlement of Investment Disputes/ International Centre for Dispute Resolution/ International Chamber of Commerce International Court of Arbitration].
- (3) Notwithstanding Article 10(2), if all the parties to an arbitration contractually agree that such arbitration shall be governed by other rules, it shall be so governed. Such agreement may be made before or after the dispute arises.
- (4) The State shall pay all costs, fees, and expenses of the arbitrations.

#### *Chapter VI: Opt In*

##### *Article 11: Opting in to this Law*

- (1) Any creditors of the State whose claims are not otherwise governed by this Law may contractually opt in to this Law's terms, conditions, and provisions.
- (2) The terms, conditions, and provisions of this Law shall apply to the debtor-creditor relationship between the State and creditors opting in under Article 11(1) as if such relationship were governed by the law of [this jurisdiction] under Article 3(3).

## *Panel Session for UNCITRAL Congress*

### *A Global Architecture for Resolution of Financial Institutions*

International trade requires international financing. The resulting interconnectedness of financial networks has increased the risk that local contagion and systemic shocks may spread to the global financial system. Neither domestic nor current international legal regimes adequately address these risks on their own. In an important paper, *Beyond the Search for Certainty: Addressing the Cross-Border Resolution Gap*, 10 Brook. J. of Corp. Fin. And Comm. L. 183 (2015), Prof. Irit Mevorach points out that the orderly resolution of financial institutions across national boundaries could be aided by a legal mechanism for recognizing resolution orders. Such a global regime could address local commercial law impediments to global resolution, while at the same time ensuring that global resolution regimes do not displace local law more than is absolutely necessary.

The panel would explore a potentially crucial role for UNCITRAL in developing such a cross-border recognition regime. UNCITRAL's experience with the Model Law on Cross-Border Insolvency offers a unique expertise and ability to balance the imperatives of local, national and regional resolution within a framework that facilitates cooperation and coordination, and provides quick and certain recognition. In particular, the panellists will explore the need to balance the imperatives of systemic safety and soundness against the existing legal doctrines that allocate financial risk among commercial parties.

### *A Global Framework for Resolution of Financial Institutions<sup>1</sup>*

*Irit Mevorach, University of Nottingham, United Kingdom*

The international legal architecture supporting cross-border insolvency and cross-border resolution is incomplete. UNCITRAL in 1997 promulgated its Model Law on Cross-Border Insolvency, a framework for global insolvency and restructuring of international commercial enterprises. The Model Law does not, however, specifically address the cross-border resolution of international financial institutions. The international standard for the resolution of Significantly Important Financial Institutions (SIFIs) identifies domestic best practices and includes high-level principles concerning the cross-border aspects of resolution regimes. However, it does not set forth a detailed cross-border resolution framework with legislative provisions that can be enacted uniformly across countries' legal systems.

Since the 2007-2009 financial crisis, and the subsequent series of collapses of global financial institutions, there have been urgent calls for action, including by standard-setting institutions, to develop a framework for the orderly resolution of financial institutions across national boundaries. Importantly, a recent initiative of the Financial Stability Board (FSB) introduced contractual solutions to enhance cross-border recognition of resolution measures, in particular the stay of termination of financial contracts and bail-in. It also emphasized the need for statutory solutions and delineated additional high-level principles that can guide legal systems as they develop statutory frameworks. These developments in the bank and SIFI resolution context promoted rethinking about the underlying goals of the general insolvency standard (within the UNCITRAL Legislative Guide and the World Bank Principles) on the treatment of financial contracts, and as a result enhanced harmonization in this area. However, the international community and standard-setters have not yet undertaken a project to develop a comprehensive global framework with legislative provisions for cross-border resolution of financial institutions.

This recent improvement of the general insolvency standard regarding the treatment of financial contracts and the increasing cross-sector consistency of best practice standards are likely to accelerate harmonization of national resolution-related laws, which in turn can support a cross-border resolution

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<sup>1</sup> Based on *Beyond the Search for Certainty: Addressing the Cross-Border Resolution Gap*, 10 Brook. J. of Corp. Fin. And Comm. L. 183 (2015), available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2831693](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2831693)

framework. However, harmonization is a slow process and progress has been mixed. It is also unlikely that full harmonization will ever be achieved. On the policy level, harmonization efforts should be constrained to provide room for local developments of resolution regimes. Domestic resolution systems may evolve over time and countries may develop innovative concepts and measures to address new challenges. It is through such experiences and developments that the regulatory landscape can remain modern and fit for purpose. Additionally, even if resolution regimes converge, a cross-border framework would be necessary to prescribe the degree of coordination in implementing the (harmonized) measures and the manner of cooperation or centralization of the process, in particular whether a certain authority takes the lead in the initiation and conduct of measures.

Currently, the UNCITRAL Model Law is the only global model available for cross-border insolvency and hence an expected point of reference when attempting to design a global framework for resolution of financial institutions. The Model Law for commercial entities was designed to provide uniformity in the application of private international law aspects, while allowing host countries to retain some control in the administration of cross-border insolvency. The prevailing argument has been, though, that the Model Law was designed for corporate non-bank enterprises, and that it did not address group structures, which are the prevalent form of global financial institutions. Financial institutions are arguably more complex and the Model Law approach therefore might be too simplistic.

It is indeed widely acknowledged that the regulation of bank insolvency has certain specific objectives, and therefore bank insolvency requires certain special rules. It has been argued in this respect that because of the need to consider objectives other than maximization of the estate value, most countries have chosen to treat bank insolvencies differently from ordinary commercial insolvencies. Yet, notwithstanding the specific concerns and special goals of resolving international banks and particularly global SIFIs, it is also important to acknowledge the significant commonalities with general cross-border insolvency. The insolvency standard emphasizes goals beyond value maximization for existing creditors. There is a consensus that an insolvency regime should balance between a range of interests and may pursue social policies. In regards to cross-border insolvency, it is agreed that pursuing the broad range of goals requires coordination between jurisdictions, facilitation of the provision of assistance to foreign proceedings, and recognition of foreign proceedings, by adopting the Model Law in national regimes. The Model Law aims to promote cooperation, greater legal certainty, fair and efficient administration of cross-border insolvency proceedings, maximization of the value of the estate, facilitation of rescue of distressed businesses, protecting investment, and preserving employment.

The Model Law has focused so far on single companies, yet it did not exclude more complex business structures such as groups from its scope. Notably, the practice shows that many cross-border insolvency cases of groups have been addressed effectively under the Model Law. Furthermore, UNCITRAL has tasked itself to address the “group gap” and to expand the Model Law to include additional tools to facilitate group solutions in cross-border cases. Thus, the Model Law is becoming increasingly relevant and can be usefully analysed and considered in the process of closing gaps in the cross-border insolvency/resolution infrastructure, while bearing in mind the specialness of international financial institutions.

*Adequate Assurance of Future Performance:  
Learning from (and Harmonizing) Banking and Insolvency Resolution*<sup>2</sup>

*John Pottow, University of Michigan Law School, United States of America*

UNCITRAL will hopefully turn its attention to cross-border financial institution resolution by building upon its successful platform of cross-border insolvency reform. Academics indeed have studied the (comparatively) more regulated system of cross-border insolvency to extract guidance. That work, in turn, compares domestic treatment of failed banks with failed private companies. For example, the United States shares a common attribute with many, though by no means all, systems, namely, that the resolution of financially distressed banks is hived off from the otherwise prevailing insolvency system rules for private company restructuring. Justifications range from concerns of systemic risk to historical path dependency, but for better or worse, banks get special treatment. Indeed, this is true both where there is a specialized regime, and also where there is not.

Two central features of developed insolvency systems is imposition of a creditor moratorium and the ability to “assume” (preserve over counterparty objection) valuable debtor contacts. But a glaring exception to these pillars is the special treatment of financial contracts, such as repos, swaps, and the like. In the U.S., under so-called “safe harbours,” they are exempt from the bankruptcy stay, and counterparties can “closeout” (terminate) these contracts over debtor objection. This destroys value for “in the money” contracts, contravening the insolvency law mantra of preservation of debtor going-concern value. (The purported justification is that such extraordinary treatment is required in the name of capital market liquidity; clearance of financial transactions should not be “gummed up” by a debtor’s bankruptcy stay. This premise is coming under increasing assault by scholars as possibly exacerbating, not reducing, systemic risk.)

By contrast, bank resolution law temporarily suspends closeout netting and imposes a brief “short stay.” This allows regulators to assess an insolvent bank’s portfolio of financial contracts, package and transfer the valuable ones to solvent transferees (solvent banks), and thereby *both* preserve the going-concern value of the contracts as assets *and* assure smooth transition and continued performance to the counterparty. Some consider it ironic that insolvency law, focused on preserving value, actually fails to protect financial contracts by allowing their destruction through the safe harbours, whereas banking law, focused on safety and soundness, preserves these contracts’ value, while remaining blasé to hysteria that any stay or interference with immediate closeout netting will grind the derivatives market to a halt.

Whatever the irony, the bank resolution system gets it right, and insolvency law gets it wrong. This is an important recognition, because if UNCITRAL follows the well-motivated impulse to use its successful insolvency reforms as a “platform” to anchor the design of a financial institutions resolution system, it has to recognize—and fix—the serious problem insolvency law presently has with financial contracts. This is especially so for two reasons: first, financial contracts are the bread and butter of financial institutions, constituting a significant share of their value; and second, many financial institutions do not fit into the narrow definition of “bank” and so must avail themselves to the insolvency law system for resolution; thus, merely replicating the bank resolution law on its own will be insufficient, even if UNCITRAL wanted to unmoor reform from the insolvency law platform.

The lynchpin of bank resolution system’s successful preservation of financial contract value is the assurance that the financial contracts will, post-assignment, be performed, and as such, the counterparties will not be harmed by the original debtor’s financial failure. The way this is done in banking law is finding a credit-worthy entity to step in and continue business with the counterparty (which bank regulators can help identify in the comparatively small world of banking).

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<sup>2</sup> Extrapolating to the international level *Implementing Symmetric Treatment of Financial Contracts in Bankruptcy and Bank Resolution*, 10 Brook. J. Of Corp. Fin. And Comm. L. 155 (2015), available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2841956](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2841956)

To integrate this banking regime into the general insolvency system to replace the safe harbours, similar assurances of financial contract performance are required to assuage the counterparties that brief delay in the exercise of their rights will be harmless. Such assurance can be provided both doctrinally and functionally. Doctrinally, the insolvency system could, like the bank resolution system, limit the debtor to a short stay to try to sell (or assume) its book of financial contracts, and, more specifically, comply with insolvency law's requirements of curing of defaults and adequate assurance of future performance. Functionally, one would "assure that assurance," so to speak, by providing financing arrangements that mimic the solvency of transferee banks, by using backstop credit facilities under an insolvency system's post-bankruptcy credit priority rules.

In sum, if international financial institution resolution regimes are to be built out on an insolvency platform—eying the success of UNCITRAL's cross-border insolvency work—then imperfections in the insolvency regimes' treatment of financial contracts must first be worked out or else the project will collapse. While some creditors might howl at suggestions that their closeout rights might require brief deferral, the international winds are already shifting with the ISDA Resolution Stay Protocol, the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, and the UNIDROIT Principles on The Operation of Close-out Netting Provisions, to name just a few. UNCITRAL is well suited to coordinate and advance this effort of integration; it must do so mindful of not repeating failures of the past.

*Bank and SIFI Resolution in the US Domestic Obstacles to International Recognition:  
A Unique Role for UNCITRAL*

*Edward J. Janger, Brooklyn Law School and Yale Law School, United States of America*

There are three distinct regimes for resolving financial institutions in the United States: (1) banks are resolved by the FDIC under the Federal Deposit Insurance Act; (2) systemically significant financial institutions (SIFIs) are resolved pursuant to the terms of Title II of the Dodd-Frank Act, either in bankruptcy, or if that is not feasible by the Orderly Liquidation Authority (OLA); and (3) non-bank financial institutions that are not systemically important are to be resolved in bankruptcy.

Resolution for banks under the FDIA is accomplished by dividing the banks into a "good bank" and a "bad bank." The good assets are transferred to (purchased by) a solvent entity, usually another bank, and the bad assets are resolved by the government. For both SIFIs and non-SIFI financial institutions, the locus of first resort for resolution is bankruptcy court. A key element of SIFI regulation under Dodd-Frank is to require SIFIs to develop a resolution plan, sometimes called a "living will." The living wills set forth a plan for resolving the firm in bankruptcy should one of the operating businesses suffer a financial shock.

These living wills are designed to facilitate and follow a so-called "single point of entry" strategy, under which the federal government does not bail out the firm through liquidity injections, but instead the investors, "bail-in" the insolvent entity. Namely, under single point of entry, if a subsidiary of a bank holding company suffers a financial shock, the group looks to the holding company as a source of strength. The holding company is expected to carry sufficient loss absorbing capacity ("TLAC") to recapitalize the insolvent entity. The parent transfers assets to the subsidiary, and then, if necessary, file for bankruptcy itself. If the holding company files for bankruptcy, the equity of the subs transfers to a trust that assumes the short term, but not the long term obligations of the holding company. The result yields a recapitalized subsidiary, and a solvent parent — thus, in theory, calming the markets and stopping a run.

Central to this goal is that the ability of the operating subsidiary to continue to perform its obligations, and that the bankruptcy of the holding company not constitute a default under its various contracts. An important aspect of the SPOE structure is that only the holding company files for bankruptcy, and the operating companies continue to perform their obligations. It is contemplated that the recapitalization of the subsidiary and the transfer of assets to the holding company would be accomplished quickly. Typically, under the FDIA, banks are resolved over the weekend, but during that period there is a short moratorium to permit assumption by or transfer of the financial firm's contracts to a solvent entity. This short moratorium

does not exist under US bankruptcy law for “financial contracts” which are subject to the so-called “bankruptcy safe-harbours.” The Lehman experience illustrates that this makes orderly resolution of a financial firm difficult in bankruptcy.

This problem has been largely remedied for systemically important financial institutions because of the creation of the ISDA Resolution Stay Protocol. The Stay Protocol implements a short moratorium by contract to allow for orderly treatment of financial institution assets. Indeed, where both of these fail, the Dodd-Frank Act offers the OLA as an administrative backstop. There is also legislation pending in Congress to implement a short stay by law. Gaps remain, however. First, issues such as fraudulent conveyance may endanger the finality of the bail-in transfers, while concerns about adequate assurance of performance may delay the assignment and assumption of key contracts, at least across national boundaries. Second, the Dodd-Frank regime and the Stay Protocol are only reliably available for SIFIs. Not all financial institutions fall into that category. Third, the category of contracts “excepted” from the bankruptcy moratorium under the U.S. “safe harbours” and Recommendations 101-107 of the UNCITRAL Legislative Guide is broader than those covered by the Stay Protocol. Fourth, the manner in which the stay protocol might be implemented in diverse international courts remains uncertain.

These gaps are uniquely within UNCITRAL’s competence to fill. UNCITRAL currently has two existing instruments that could, relatively easily, be supplemented to fill these gaps. To the extent that national regimes currently use bankruptcy law as their resolution forum, the UNCITRAL Model Law for Cross-Border Bankruptcy provides an effective recognition framework under which resolution orders might be recognized across borders. Where financial institutions are involved, it might be necessary to provide mechanisms for accelerating recognition and cooperation, but there is no need to reinvent the wheel. With regard to the need for short stay treatment of financial contracts, adequate assurance of performance and finality, the UNCITRAL Legislative Guide for Insolvency could be supplemented to include provisions relating to the insolvency of financial firms. These provisions could be brought into conformity with current best practices for financial firm resolution, such as: the European Union Bank Recovery and Resolution Directive, European Union Directive on Financial Collateral Arrangements, the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, and the UNIDROIT Principles on The Operation of Close-out Netting Provisions.

Such an effort would require cooperation and consultation between insolvency experts, bankers and bank regulators. The work of this project would build on the work of UNCITRAL Working Group V, but steps would need to be taken to coordinate this project with the efforts of the FDIC, FSB, the EU and others. This is a challenge, but one worth undertaking.

### *European Bank Resolution and Insolvency Priorities*

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One domain where corporate insolvency and bank resolution systems separate and, at the same time, intertwine, involves the hierarchy of claims: on the one hand, the regulation of distressed financial institutions tends to have a set of priorities that does not coincide with those generally included in ordinary insolvencies; on the other hand, bank resolution systems often make express reference to the general hierarchy of claims envisaged in the insolvency law. When the bank has international connections, the inconsistency of the system of priorities in different countries makes the application of bank resolution systems even more complex. Addressing the inconsistencies between different regimes as well as the problems of conceptual interpretation (cross-comparison of priorities) and practical implementation is paramount for the adequate understanding of bank resolution regimes. In particular, the following needs to be analysed:

Analysis must begin with a discussion of the conceptual differences between the system of priorities in corporate and bank insolvencies. In the case of general insolvency law, the content of priorities shows the jurisdiction’s level of consistency with market principles (gauged, for example, by the level of respect

of pre-insolvency entitlements) as well as a set of social values (who gets what of what's left is, in part, a decision of social policy). The regulation of bank insolvency, however, is especially concerned with the maintenance of financial order and the avoidance of systemic contagion. In terms of priorities, this is reflected in the inclusion of early intervention mechanisms and in the pre-determination of certain types of creditors that must early, inevitably, and publicly take losses, so that the rest of creditors are protected, panic does not spread, and the system continues to operate in an orderly manner. Total Loss Absorbing Capacity —TLAC- or the minimum requirement for own funds and eligible liabilities —MREL- rules are unique to banks, and they represent systems of pre-insolvency priorities. This is complemented — in the most advanced systems- by a definition of “bail-in-able” claims (i.e., those claims that must bear the losses when —normally- the entity is insolvent). When a third layer of creditors is concerned, bank insolvency mingles with corporate insolvency, and often a reference to the general system of priorities is included in the bank resolution system. But things are, in practice, far from easy. The application of general corporate law priorities to the insolvency of a bank presents a number of problems.

Problems become bigger when, as is the case for the larger financial institutions, there is a cross-border element to the bank's insolvency. It is not uncommon that private international law rules differ from the approach taken in case of corporate insolvency. Insolvency law's focus on COMI often gives way to the place of authorization of the entity, with a single point of entry. Applicable law, however, tends to remain with each of the territorial jurisdictions where the banks are active. This entails different systems of priorities, and the need to make the treatment of similar creditors consistent. The definition of security rights, the diverse typology of the security rights and of certain classes of creditors, the concept of administrative expenses, or even the characterization of depositors all have to be managed in a way that is consistent and allows for an orderly and value-preserving resolution. There is potential for conflict depending on how the different priority regimes apply to relevant liabilities, which provides a further source of complication.

There is more. Concerns about the institutional framework and the protection of basic rights of creditors must be addressed. Bail-in powers are often implemented by administrative authorities, without any court involvement. This may present problems of constitutionality in some countries. The challenge is also conceptual: is it justified, constitutionally, to impose a write-off of what many systems consider a right-credit—in cases where the loss of economic value of the claim has not been properly established? Problems of discrimination between economically homogenous creditors may also arise. Good examples of the problems that may arise can be found in recent years in the midst of the financial crisis. Maybe Iceland's decision to protect national depositors and bail in international deposit holders is a clear case (*Icesave* case).<sup>3</sup> Further, the cross-border application of certain measures may also present problems of breach of the fundamental rights of creditors and their access to justice. Often, decisions will be adopted by “colleges” of national resolution authorities that have no separate legal personality and uncertain legal nature. How creditors may defend their rights (especially their constitutional right of property) is under-theorized and begs rigorous comparative analysis. Even within regionally integrated structures, like the Eurozone, the resort to the European Court of Justice or to the European Court of Human Rights is available under at-best unclear circumstances.

Accordingly, if UNCITRAL is to consider moving forward in establishing tools for cross-border resolution of distressed financial institutions, it has much work to do on the comparison of priority provisions. Scholars have begun that work, myself included but there is much more to do.

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<sup>3</sup> Case E-16/11 EFTA Surveillance Authority v Iceland, 28 January 2013.

## *Making Global Bail-in Work — A UK Perspective*

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“Cross-border banks are international in life, but national in death.”

### *Background*

The paternity but not the truth of this aphorism is disputed. As the GFC broke in 2007, national regulatory authorities were only able to provide mostly local responses to the distress of major cross-border banking groups. Even when individually rational, such responses often proved collectively value-destructive, imposing avoidable costs both on direct financial stakeholders including depositors and on various sets of taxpayers. Such uncoordinated responses also failed adequately to mitigate ‘common lender’ (a group entity based in one jurisdiction reduces operations as a result of the distress of another member of the group based in a different jurisdiction) and ‘wake-up call’ (investors adversely affected in one jurisdiction withdrawing from other jurisdictions they considered relevantly similar to the first) effects. The result was the creation of additional cross-border channels for the transmission of risk and loss.

Since the GFC, an impressive cross-border regulatory architecture has been created, but significant lacunae remain. A brief assessment of this architecture, and of ‘bail-in’ requirements in particular, demonstrates the need for an international instrument to plug these gaps. The assessment draws inspiration from the treatment of globally systemically important financial banks (‘GSIBs’). And it examines the particular approach of the UK, which is home to four and host to another 14 of the 30 banking groups characterised as GSIBs by global regulatory authorities. With such an outsized financial sector, the UK has an important stake in and perspective on the resolution of cross-border bank distress.

### *Post-GFC resolution approaches*

As a matter of post-GFC consensus, the tools required for successfully resolving distressed banks are bail-in (conversion of particular types of unsecured debt into equity), a moratorium or ‘stay’ on contractual termination (‘closeout’) rights that become available simply because of the onset of distress or commencement of the resolution process, and the ability to transfer some or all of the business to a healthy buyer (or temporarily to a bridge bank).

Regulatory authorities led by the Financial Stability Board (‘FSB’) have identified 30 GSIBs with eleven home states. GSIBs have been identified using a combination of size of exposure, interconnectedness, lack of readily available substitutes for their services, cross-jurisdictional claims and liabilities, and complexity. Each GSIB is subject to higher capital buffer requirements, total loss absorbing capacity (‘TLAC’) made up of sufficient equity and debt to absorb losses and recapitalise relevant parts of the group without resort to taxpayer funds, group-wide resolution planning and resolvability assessments, and higher supervisory expectations. Each GSIB is placed within the purview of a ‘crisis management group’ (‘CMG’) composed of relevant authorities in its home and key host jurisdictions.

Most GSIBs operate on a centralised basis, and their CMGs have agreed resolution strategies based on a ‘single point of entry’ (‘SPE’). The remaining GSIBs operate through regionally distinctly managed and financed sub-groupings. Their resolution strategies envisage regional ‘multiple points of entry’ (‘MPEs’) that would replicate the SPE model at the respective regional levels and with unavoidable additional complexity. Under the SPE model, one group member — usually the holding entity — is subjected to a bail-in to recapitalise either it or the transferee of the distressed bank’s critical functions. The closeout stay enables value to be kept within the distressed entity long enough to enable such a transfer, and consequent upon a successful transfer and in the absence of a subsequent substantive default, closeout rights are lost.



### *Bail-In: The UK approach*

The Bank of England's November 2016 policy identifies three resolution approaches: (i) bail-in to keep the bank open, which would be necessary for the largest and most complex banks which would likely be performing non-substitutable functions and/or have businesses too large to be assumed by another; (ii) partial transfer for banks that perform significant critical functions in the financial markets and for whose businesses buyers might be found; and (iii) liquidation in all other cases. Banks likely to fall under the first of these approaches are subject to a TLAC about twice the minimum capital buffer, and TLAC resources must be subordinate to those liabilities that the bank must continue to discharge if it is to continue to perform critical functions. Banks likely to fall under the second approach are subject to lower TLAC requirements since only the critical parts of their business that are transferred would require recapitalisation.

### *Remaining lacunae*

Two critical gaps remain in relation to the cross-border recognition of resolution measures. The first relates to the cross-border recognition of stays on closeout rights and respect of substantive rights in resolution so long as there is no substantive default under those contracts. This is accomplished through the ISDA Stay Protocol, examined by Prof. Pottow;

The second relates to the cross-border recognition of bail-in measures. Where liabilities that would otherwise be part of TLAC resources are governed by non-UK law, the Bank of England requires that the governing contracts include a term by which the creditor would agree to the Bank exercising bail-in powers. It quickly became apparent that this would not always be practical, such as when such clauses would be contrary to the governing foreign law. This has necessitated the Bank in June 2016 promulgating the aptly named "Contractual Recognition of Bail-in: Impracticability" document exempting banks from seeking to introduce recognition clauses. The resulting lacuna is manifest.

### *The need for an international instrument*

An obvious solution lies in an international instrument providing for the cross-border recognition of both closeout stays and bail-in. As the author of the Model Law on Cross-Border Insolvency that provides for the recognition of and assistance for foreign insolvency proceedings, UNCITRAL has unparalleled experience in the creation of such an instrument and is uniquely placed to convene the required regulatory and legal expertise.

## *Micro, Small and Medium Enterprise Insolvency in Africa: a comparative study*

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### *Introduction*

Ms. Obadi owned a medium-sized sole proprietorship, a Bed and Breakfast inn, in East Africa. It was relatively successful, with a steady stream of foreign tourists, and as it was in a remote region, it employed a number of locals in an area with few jobs. However, following a terrorist attack, the tourism sector suddenly shrank in the country, and severely impacted Ms. Obadi's business. Overwhelmed with business debts, she was left with no choice but to close down. As the Bed and Breakfast was a sole proprietorship, there was no separation between her personal debts and the debts of the business. As is the case in many jurisdictions regarding sole proprietorships, the person and the business were treated as the same entity and were regulated by consumer bankruptcy frameworks--as opposed to incorporated businesses where the emphasis is largely on the survival of the business she put so much effort into. As a result, Ms. Obadi was obliged to file for personal bankruptcy. Due to the fact that there were no efficient attempts to rescue, or at the very least, to efficiently liquidate her ongoing business, Ms. Obadi ultimately lost her home and most of her possessions.<sup>1</sup> This caused her to enter into a spiral of debt from which it would take decades to emerge.

Ms. Obadi's story illustrates the importance of micro, small and medium enterprise ("MSMEs") insolvency, which, apart from incorporated companies, often comprise unlimited liability partnerships, sole proprietorships or sole traders—the latter are especially abundant in jurisdictions, such as those in Africa, where the informality is high. MSMEs make up the majority of businesses in the world. Although the diversity and sheer number of MSMEs makes it difficult to properly quantify them and measure their impact, they represent the majority of businesses in most jurisdictions and are key drivers of employment, economic growth, and entrepreneurship.<sup>2</sup> Moreover, economic statistics suggest that small/young firms are the engines of job creation and that, in order for these firms to thrive, entry and, crucially, exit to and from the marketplace must work effectively. Evidence shows that around 20% of these new firms go out of business after their first year and just over 50% after five years. In Africa, the figures are even higher, with obstacles such as constrained access to credit and limited opportunities for firm growth and trade accelerating MSME business failure. In order to encourage the survival of such businesses and in turn promote entrepreneurship, employment and the ability to successfully export, the domestic insolvency regime needs to be appropriately designed to encourage small business rehabilitation where feasible and fast, efficient liquidation, where rehabilitation is not feasible.

An efficient insolvency system of commercial insolvency (inclusive of both incorporated and unincorporated businesses) must be inspired by the "Insolvency Standard" set by the UNCITRAL Legislative guide<sup>3</sup> and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes<sup>4</sup> (jointly, "the Insolvency Standard"<sup>5</sup>). When it comes to insolvency of natural persons, there is no "best practice" and countries have adopted a variety of ways to try to address such a complex issue. A few jurisdictions simply do not have personal insolvency regimes. Other countries differentiate the treatment of natural persons engaged in business activities from those that are merely consumers. Other jurisdictions do not establish such separation, treating both corporate and natural persons under the same insolvency framework. While one of the main objectives of the corporate insolvency system is to maximize the value of the debtor's estate—including liquidating the company and shutting it down if that provides the highest

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<sup>1</sup> In this particular case, there was no exemption of the house as one of the assets excluded from personal bankruptcy.

<sup>2</sup> World Bank Group, Report by the Working Group on the Treatment of MSME Insolvency (2017 — forthcoming).  
<sup>3</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/2004Guide.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html)

<sup>4</sup> <http://documents.worldbank.org/curated/en/557581467990960136/Principles-for-effective-insolvency-and-creditor-debtor-rights-systems>.

<sup>5</sup> As it emerges from the Financial Stability Board's website, "The ICR Standard is comprised of the World Bank Principles for Effective Insolvency and Creditor Rights Systems (2011) and the Recommendations from the UNCITRAL Legislative Guide on Insolvency Law (2010)." [http://www.fsb.org/2011/01/cos\\_051201/](http://www.fsb.org/2011/01/cos_051201/).

value to creditors —the same cannot be done with an individual. Many social considerations enter to play when it comes to the treatment of the insolvency of natural persons.

Both UNCITRAL and the World Bank Group are interested in understanding how jurisdictions around the globe are currently dealing with small business insolvency and whether this can inform the creation of best practice principles for MSME insolvency. This paper provides a comparative analysis of how MSME insolvency has been dealt with in some African jurisdictions by assessing two models: (1) applying individual or consumer bankruptcy regimes to address the insolvency of all natural persons, including those engaged in business activities; and (2) applying to those natural persons engaged in business activities a set of simplified and stream-lined insolvency provisions that have been adapted specifically for small businesses and traders by tweaking a more general commercial insolvency framework. In particular, the paper assesses the pros and cons of these models, taking into account issues of particular concern for MSMEs in Africa —such as high levels of informality, the prevalence of micro businesses over larger ones, and the difficulties in accessing credit without immovable collateral. Ultimately, it seeks to provide input for addressing MSME insolvency regulation in a developing country context, as well as more generally contributing to the literature on the importance of MSME firm growth and trade.

### *The importance of MSME insolvency*

MSMEs have several aspects that differentiate them from large corporations when facing a situation of financial distress. MSMEs typically have more issues accessing financing, they are more vulnerable to macroeconomic shocks and they typically fail in larger numbers than big corporations do. MSMEs are often times informal and reasonably unsophisticated compared to large limited liability corporations. MSMEs also have a blurred separation between the ownership and the management of the company, which makes them quite different from large corporations that have robust corporate governance standards and a separation between shareholders and the management body—as well as stricter accountancy regulations. Similarly, there is often confusion when it comes to differentiating between the personal debts and assets of an individual operating an MSME and the debts and assets of the business itself (particularly at times of financial distress). These factors, as well as many others, have a series of natural implications for the insolvency of MSMEs.

In the first place, MSMEs are more reluctant than large corporations to resort to formal insolvency proceedings. This is a product of costs, of access to expert advice and of the owner/manager being overly optimistic that s/he has solutions for all of the company's potential issues. Furthermore, the consequences of several bankruptcy regimes are quite unappealing for small entrepreneurs and can include separation from the administration of the business and, in some cases, even personal prohibitions such as limitations on leaving the country without previous notification or approval of the court in charge of the insolvency process. These factors, among others, contribute to the stigma surrounding the process that disincentivizes MSMEs from seeking judicial arrangements when, perhaps, such a tool could save the business.

Creditors, similarly, have relatively little interest in a typical MSME insolvency proceeding. While the role of creditors in restructuring is paramount, most financial entities (the most common type of creditor in insolvency processes) would have a reasonably limited exposure to each MSMEs and they may have already provisioned the possible loss —depending on the respective country's Central Bank regulation. Finally, secured creditors (including financial institutions) might also be disinterested in the process if they are entitled to proceed with the actions of enforcement.

Another complexity of MSME insolvency is the limited information that the parties can access during the proceeding. As a result of the informality mentioned in the preceding paragraphs, MSMEs' book keeping is generally poor, which results in more challenges at the time of determining the assets of the debtor, the list of creditors, and so on.

Partly due to these factors, MSMEs have limited incentives to resort to insolvency processes to restore their viability. In many jurisdictions, if not the majority, insolvency laws are very complex, require the involvement of many different stakeholders and have a high cost associated with their implementation.

These remedies may or may not be adequate to address MSME insolvency—and this is, partly what inspired the current paper.

### *Why MSME Insolvency in Sub-Saharan Africa*

From a technical perspective, the African continent provides an interesting region for examining different approaches to MSME insolvency regulation. Not only are there a large number of countries, many of which are currently reforming their insolvency regimes, but they cover a variety of legal systems including francophone and lusophone civil law, anglophone common law, Roman-Dutch and mixed legal systems. This paper focuses specifically on certain jurisdictions inspired by English common law (primarily in Southern and East Africa) and some jurisdictions inspired by French civil law (primarily in West Africa).

Secondly, there is evidence that in many African countries, lending to all businesses is perceived as a high risk activity, not only vis-à-vis MSMEs. The most reported reason for this is that formal recovery through the courts is extremely time-consuming and costly.<sup>6</sup> Financial institutions often attempt to offset this risk by high collateral requirements—predominantly with immovable collateral. However, micro and small businesses are the candidates most likely to fail to meet such collateral requirements and therefore struggle to access capital to start, develop and expand their businesses. Over 50% of MSMEs are reported as struggling to access capital globally.<sup>7</sup> It is therefore unsurprising that small business failure is high, and developing tools to promote MSME recovery and growth is therefore particularly important in the Sub-Saharan Africa region.

Thirdly, there is traditionally a stigma attached to bankruptcy proceedings. The origin of the word “bankruptcy” is already stigmatic, involving the breaking of the bench of those debtors that were unable to pay their debts. As commercial law evolved in the last quarter of the previous century, the focus began to switch to the economic reason behind the insolvency. This new outlook focused on a non-guilty and non-punitive approach that emphasized the importance of restructuring and keeping businesses as a going concern, keeping entrepreneurs encouraged to continue to innovate, and the like. Not all legislation has been modernized, however. It is still common to find many insolvency laws that maintain the traditional punitive approach and which contributes to the permanence of the stigma—apart from cultural reasons that are even harder to change<sup>8</sup>. In many countries in the African continent, it is still common to find insolvency laws that contemplate imprisonment for a variety of minor business offences such as poor record keeping or for not filing certain statements of affairs verified by affidavits and so on. What is more, there is still widespread acceptance of limitations of personal movement (not being able to leave the country without court permission) in cases of personal bankruptcy.

In order to encourage the survival of small businesses and in turn promote entrepreneurship, employment and the ability to export, the domestic insolvency regime needs to be appropriately designed to encourage small business rehabilitation where feasible, and fast/efficient market exit where in all other cases. The next sections of this paper describe two comparative systems that aim to do this.

### *Personal Bankruptcy Frameworks Covering Small Business Insolvency Southern and East Africa*

Many Roman Dutch legal systems in Southern Africa are influenced by English common law (for instance, South Africa, Zimbabwe, Lesotho and Namibia). Other jurisdictions, in light of their colonial heritage are strongly rooted in English common law, such as Malawi, Zambia, Uganda and Kenya. All of these jurisdictions deal with unincorporated small business debts in the manner described in the introduction—namely there is only one insolvency regime applicable to all natural persons, regardless of whether they were carrying on a business or not. Some of these acts find their inspiration in the UK

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<sup>6</sup> World Bank Group assessments.

<sup>7</sup> <http://www.worldbank.org/en/topic/financialsector/brief/smes-finance>.

<sup>8</sup> An interesting discussion on this topic can be found in the following FT article: <https://www.ft.com/content/d0509a98-78ab-11e5-933d-efcdc3c11c89>.

Insolvency Act of 1986<sup>9</sup>. A small unincorporated business, such as a sole proprietorship, going through insolvency is therefore obliged to use the same personal bankruptcy framework as consumers would and, among other obvious consequences, the insolvency system does not put any emphasis on the survival of the underlying business carried by the natural person. As it is well-known, the objectives of the consumer business regime are not necessarily the same as the ones of business, therefore, some of the consumer solutions applied to an entrepreneur, like the owner of a sole proprietorship, may seem at least theoretically controversial.

In many of the already mentioned jurisdictions under this model, the personal bankruptcy frameworks were, or continue to be, extremely outdated and anachronistic—making them unsuitable for addressing small business distress. Indeed, it is perhaps unsurprising that across the board in these jurisdictions, there were reportedly very few bankruptcy cases, —for individuals or otherwise. For instance, Malawi’s personal insolvency law (prior to its recent reform in 2014) dated from 1928.<sup>10</sup> Although the law did enable an individual to declare his or her intention to present a petition for a declaration of bankruptcy and propose a personal bankruptcy arrangement, there were no requirements for banks to provide notice of impending bankruptcy to customers, nor any counselling services or institutions for administering and regulating Malawi’s personal bankruptcy system.<sup>11</sup> In Seychelles, the Bankruptcy and Insolvency Act (prior to its reform in 2013) was originally from 1853, albeit with amendments. In Zambia, the personal insolvency regime is from 1967 and is reportedly rarely used in practice.<sup>12</sup>

### *Unified Insolvency Law*

Many of these countries have recently revised their insolvency regimes, and a trend in the region appears to be putting a unified insolvency law in place. A unified insolvency law is a single statute that covers individuals, unincorporated businesses and corporates, albeit it in different chapters or sections. Such a unified statute has various advantages, including that it is administratively expedient to have all the laws relating to insolvency—for corporates and natural persons alike—in a single statute, and that fragmented legislation in multiple statutes typically causes unnecessary duplication and confusion. Some of the countries that have put a unified insolvency statute in place include: Kenya (2015); Malawi (2014); Mauritius (2009); Seychelles (2013); and Uganda (2011). Lesotho and Zimbabwe are also currently drafting unified insolvency Bills. It is hoped that by replacing out-of-date personal bankruptcy statutes with a more effective personal bankruptcy regime, lender confidence will be increased in lending to MSMEs because the improved insolvency process provides lenders with more certainty and predictability with respect to recovering on defaulted loans.<sup>13</sup>

### *Alternatives to Bankruptcy*

The countries that have reformed their laws in Southern Africa have tended to include an alternative to bankruptcy in the legal text. This is particularly important when considering distressed MSMEs. These businesses do not have the option to go through a formal restructuring that viable corporates would normally undergo in a corporate insolvency regime. Having said this, given the size of a typical MSME in Southern Africa, it is debatable whether such a formal rescue procedure would really be suitable. Moreover, including such an alternative helps avoid the stigma that bankruptcy proceedings have traditionally carried—particularly in small communities. Allowing businesses to negotiate debt restructuring without losing their reputation maximizes the likelihood of the business being saved, which consequentially makes creditors more likely to extend financing.

<sup>9</sup> <http://www.legislation.gov.uk/ukpga/1986/45/contents/enacted>.

<sup>10</sup> Laws of Malawi, Cap. 11:01 of April 14, 1928.

<sup>11</sup> World Bank Group, “Malawi: Diagnostic Review of Consumer Protection and Financial Literacy” <[http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/MW\\_CPFL\\_Vol\\_II\\_Final.pdf](http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/MW_CPFL_Vol_II_Final.pdf)>

<sup>12</sup> World Bank Group Technical Note, Financial Sector Assessment Program 2016.

<sup>13</sup> The World Bank Group, “Debt Resolution and Business Exit.” Viewpoint, 2014. [https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-businessexit/upload/VIEWPOINT\\_343\\_Debt\\_Resolution.pdf](https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-businessexit/upload/VIEWPOINT_343_Debt_Resolution.pdf) at 3.

Examining the new insolvency laws in Malawi, Seychelles and Zimbabwe, the alternative procedure is the individual voluntary arrangement (IVA), modelled on a similar procedure in the United Kingdom. Procedurally, a natural person debtor (consumer or business owner) enters into an arrangement with his creditors on a voluntary basis, thereby avoiding the disadvantages of being declared formally bankrupt. The procedure is quick and inexpensive, and from the creditors' perspective, increases the likelihood of receiving reasonable returns. In Malawi, the provisions dealing with individual voluntary arrangements also contain a provision allowing for a fast-tracked individual voluntary arrangement. Uganda and Kenya also have similar provisions.

The process itself is quite simple: it permits a debtor to obtain an interim order, whose effect is to temporarily suspend the actions of enforcement against the debtor for a certain period of time (usually, a few weeks<sup>14</sup>). In order to be granted the interim order, the debtor has to commit to presenting a proposal of a plan to the creditors in order to achieve an arrangement of her or his debts. Once the creditors' meeting takes place, the proposal is considered therein. Kenya has a few more "divisions" within its legislation which contemplate an even more expedited process and a special division for when a person lacks any assets<sup>15</sup>.

### *Bankruptcy Procedure*

Laws such as those in Uganda, Kenya and Seychelles, just to quote a few examples under this model, contain provisions for personal bankruptcy without differentiating consumers from business owners, which would be directly applicable to business owners of an unincorporated entity, such as a sole proprietorship. The bankruptcy process for natural persons contemplated in these jurisdictions begins with a petition that may be filed by both the debtor herself/himself and their relevant creditors, if they meet the requirements indicated in the respective laws. Once the process is initiated, the debtor is publicly examined and required to file an affidavit stating her or his creditors—sometimes under very strict penalties if the debtor fails to do so. If the court adjudges the debtor bankrupt, then an authority (typically, an official receiver or a trustee) is appointed to take custody and control of the debtor's estate, among other typical consequences of the insolvency process. All of these provisions are reasonably standard in insolvency systems around the World.

These laws and, generally, laws that fall under this model in Southern and Eastern Africa, contain several provisions and omissions that are relevant for MSME insolvency. In the first place, it is important to notice that most legislations under this model have a provision that exempts certain personal assets from the debtor's insolvency. In this sense, Uganda for example, prevents creditors from attacking the "a) tools, books and other items of equipment which are necessary to the bankruptcy for use personally by him or her in his or her employment, business or vocation of a value to be prescribed; b) [...]"<sup>16</sup> Kenya has a similar provision, authorizing the debtor to keep the "necessary tools of trade"<sup>17</sup>, while Seychelles' new insolvency law also has a provision exempting the "tools, books, vehicles and other items of equipment as are necessary to the bankruptcy for use personally by him or her in his or her employment business or vocation up to a maximum value of..."<sup>18</sup>. Some other provisions, reasonably typical under this model, impose limits to the debtors' activities. These include limitation that forbid the debtor from taking part in the management or control of any business or to even be employed by any company that is owned or managed by relatives, imposing severe consequences (up to a 2-year imprisonment) in case of contravention<sup>19</sup>. These systems generally do not appear to specify that the appointed receiver or trustee needs to have any specific knowledge about the debtors' affairs. It seems possible, if not likely, that in the case of the Bed and Breakfast with which we started the paper, a non-expert (and individual not well versed in the management of such a business) could have been assigned. This seems to be the case precisely because the main stakeholders involved will be more familiar with consumer cases. If the trustee that takes over the administration of Ms.

<sup>14</sup> For example, both Uganda (Art. 121) and Kenya (Art. 306 (5) establish 14 days as the duration of the interim order, giving the court the flexibility to extend it if it deems appropriate.

<sup>15</sup> Division 3, Art. 343 onwards.

<sup>16</sup> Art 31 Uganda's insolvency law (2011).

<sup>17</sup> Art. 161 (2) Kenya Insolvency Act (2015).

<sup>18</sup> Art. 28 (2) Seychelles insolvency act (2013).

<sup>19</sup> Art 152 Kenya Insolvency Act (2015).

Obadi's estate is inadequate, the likelihood of the business' survival is indeed slimmer<sup>20</sup>. Managing a business is difficult and managing a business in financial distress, even more so. The incentives of a sole proprietor to resort to proceedings like this, precisely for the reasons above, are also quite doubtful.

Almost all of the jurisdictions have as a final objective a debtor's "discharge" by which, given certain requirements, the debtor would be released from her/his obligations in the future. The notion of "discharge" is widely accepted in comparative jurisdictions and it is generally agreed that the notion of discharge is essential for debtors to continue to contribute to the economy after an insolvency process. Some of these legislations determine that the discharge is obtained by the mere passage of time<sup>21</sup>, however, some others leave the discharge to the discretion of the court after hearing the official receiver—making it possible that a debtor's future income is destined to remain committed to the repayment of the old debts, seemingly, for an indefinite period of time<sup>22</sup>.

Under this model, none of the personal insolvency laws reviewed appears to require either the trustee or the court, in cases of a sole proprietorship or for a trader, to attempt to maintain the business as a going concern. This invites reflection upon whether these regulations are suitable (or not) for the particular case of unincorporated MSMEs.

### *Bespoke Frameworks for Small Business Insolvency: West Africa*

The Organization for the Harmonization of Business Laws in Africa (OHADA) comprises seventeen West African States that predominantly are francophone with civil law legal systems. OHADA recently adopted a revised uniform insolvency law that is directly applicable on all member state jurisdictions. Among other reforms, the law provides for the new simplified regulation of MSMEs. Developed in recognition of the fact that most businesses in the OHADA region are small-scale and that the longer it takes to address their financial distress, the less likely it is that there will be a possibility to recover any assets. These appear to be the first insolvency provisions in Africa that have been specifically designed for small businesses and it will be interesting to monitor how successfully they address MSME insolvency.

The OHADA insolvency law differs from the previously described Roman-Dutch/common law jurisdictions insofar as the scope of the insolvency law specifically includes small businesses and natural person owners of unincorporated businesses. It states that it is applicable to every natural person undertaking an independent professional, civil, commercial, artisanal or agricultural activity, as well as every legal person in private law, including public enterprises.<sup>23</sup> The OHADA states ultimately agreed that in the context of their diverse member state economies, a "small business" would constitute a proprietorship, partnership or other natural or legal person having less than or equal to 20 employees and a turnover not exceeding 50 million francs CFA (around US\$80,000) in the 12 months prior to proceedings.<sup>24</sup> Moreover, these MSMEs have the option to select simplified proceedings, but are not obliged to do so.<sup>25</sup> This provision was to ensure that due process was retained and businesses could retain the option to go through more extensive judicial procedures if they deemed it necessary.

The simplified proceedings apply to three of the four procedures set out in the law, namely *règlement préventif* (preventive settlement); *redressement judiciaire* (reorganization) and *liquidation des biens* (liquidation). They are simplified insofar as many of the formalities related to the filings or hearings are no longer necessary, in order to facilitate faster processes.

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<sup>20</sup> Some legislations contemplate the possibility for the trustee to "allow the bankrupt to continue to manage the estate or part of it" (i.e. Uganda's law, Art. 34), but this is a faculty of the trustee, and by no means an obligation.

<sup>21</sup> Kenya Insolvency Act (2015), Art. 254

<sup>22</sup> See, for example, Uganda's law Art. 42. (3).

<sup>23</sup> Article.

<sup>24</sup> Article 1-3.

<sup>25</sup> Article 1-2.

### *Règlement Préventif (Preventive Settlement)*

The simplified provisions for *règlement préventif* or preventive settlement, are in the form of derogations from the ‘main’ or overall *règlement préventif* proceeding. They provide that any small business conforming to the definition (set out above) may open proceedings before they are in a state of insolvency. The filing requirements are simplified. For instance, the procedure can be opened even if no plan or arrangement has been provided, and although documents demonstrating the financial situation of the small business need to be filed, these do not need to be audited and comprehensive financial statements or cash-flow statements are not needed as they are with the general proceeding.<sup>26</sup> In the event that any other documents required to be submitted cannot be provided, or can only be provided incompletely, the request must indicate the reason for their absence. As stated above, the debtor may request that the simplified procedure should not be applied and that regular proceedings are instead opened. The decision of the competent court to apply the simplified procedure is not subject to appeal. The simplified procedure also imposes shorter timeframes compared to the general procedure, for instance, regarding the administrator’s obligation to file the report containing the agreement between the debtor and its creditors (2 months since the opening of proceedings instead of the regular 3, with a possible extension of 15 days instead of 1 month). The restructuring plan is required to be prepared by the debtor with the assistance of the administrator and can have more simplified content than the plan under the general proceeding.

### *Redressement judiciaire (reorganization)*

As with preventive settlement, the form of simplified reorganization proceedings is a derogation from the general reorganization process.<sup>27</sup> As with the general proceeding, the filing must be made by an insolvent debtor within 30 days of insolvency (using the cash-flow test), but with fewer documents required and must be accompanied by a sworn statement attesting that it meets the conditions of a simplified reorganization. The reorganization plan must be filed, with the assistance of an administrator, within 45 days of the declaration of insolvency.<sup>28</sup> Unlike the more detailed reorganization plan in the general reorganization process, in the simplified proceeding, the plan may be limited to payment terms, debt relief and the possible guarantees that the entrepreneur must make to ensure its execution. The financial statements and economic records are not required to be submitted alongside the simplified reorganization plan.<sup>29</sup> The court can decide to convert a general reorganization to a simplified reorganization within 30 days of opening the proceedings following representations from the administrator.<sup>30</sup> At the request of the debtor or administrator, the court can decide not to follow the simplified reorganization process.

### *Liquidation des biens (liquidation)*

The conditions for opening the simplified liquidation are the same as reorganization. As well as meeting the definition of small business, however, there is an additional condition that the debtor does not own any immovable property. A sworn statement must be submitted attesting that the debtor meets the relevant conditions for a simplified liquidation proceeding. After the opening of a liquidation process, the liquidator may, within thirty days of his appointment, prepare and file a report with the competent court. On the basis of this report, the court may apply a simplified liquidation procedure after having heard or summoned the debtor. The court has the right to refuse to apply the simplified liquidation proceedings, even if the relevant conditions are met. Unlike with the general liquidation proceeding, the court may determine that the sale of the debtor’s property should be a private sale agreement.

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<sup>26</sup> Article 6-1.

<sup>27</sup> Article 145-1.

<sup>28</sup> Article 145-3.

<sup>29</sup> Article 145-4.

<sup>30</sup> Article 145-5.



## *Comparative Assessment*

At this stage, it is difficult to assess which insolvency regime is most effective for MSMEs. Very little data has been collected with respect to common law systems in order to understand whether small businesses have been effectively rescued using tools such as IVAs. The OHADA provisions are too new and have not been implemented yet in all applicable countries, so it is similarly difficult to know if they will be used on a wide-scale basis.

### *Business debts are treated as distinct from consumer debts*

Although many of the goals of consumer and business insolvency are similar, there are a few areas where these objectives are not necessarily aligned. The treatment of a natural persons' insolvency when they are engaged in business activities together with consumer insolvency may end up having a detrimental effect if the result is to disregard the importance of maintaining and maximizing the possible value of the business that the person managed to build. The opposite is also true: Treating small unincorporated traders as large corporations may have the opposite unfair effect, which is to impose extremely complex, lengthy and costly procedures to a small trader that is not sophisticated and most certainly not incentivized to resort to such procedures.

An added layer of complexity to this matter is that distinguishing between the personal and business debts of a natural person can be extremely challenging, as identified in the UNCITRAL Legislative Guide<sup>31</sup>, which may make it extremely complex to attempt to trace a distinction solely on that basis. It seems that, at least from a theoretical point of view, a regime that deals specifically with MSMEs without forgetting the human qualities of the entrepreneurs (i.e. by contemplating a “discharge”, for example) may be a positive solution to these types of problems.

Business debts are a product of the market, and there is accordingly a strong rationale for treating them purely with economic concerns and efficient market functioning policies in mind; whereas consumer insolvency raises many other social considerations that policy-makers might want to consider. This is not to say that traders or entrepreneurs should not be afforded certain protections or incentives in an insolvency regime, but rather that governments might be interested in drawing a line between the treatment of debts incurred whilst in the course of commercial activity and those incurred in non-business dealings.

Both “models” mentioned above capture to some extent some of these positive and negative aspects. The OHADA model seems to focus more on the business aspects of the entrepreneur, in an attempt to achieve a higher survival rate of businesses as a going concern. The Southern and Eastern African model seem to focus more on the entrepreneur as a natural person and, therefore, on the possibilities of obtaining a discharge—however, with less regard to rescue or sale of an individual's business as a going concern.

### *The focus on fast and cheap insolvency proceedings is an important consideration*

All businesses are deterred by the prospect of lengthy and often costly legal proceedings, and this becomes an even bigger obstacle for smaller businesses. Creditors also suffer as a result of lengthy proceedings, with value continuing to leach from the debtor's estate and minimizing creditor recovery. The World Bank Group *Doing Business Report 2017* reports that it takes around 3 years to complete insolvency proceedings in Sub-Saharan Africa with an average of 20 cents on the dollar ultimately recovered by creditors.<sup>32</sup> In comparison, in OECD High Income countries, it reportedly takes 1.7 years on average to undergo insolvency proceedings, with creditor recovery being around 73 cents on the dollar.<sup>33</sup> Given the

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<sup>31</sup> “...it is often difficult to separate an individual's personal indebtedness from their business indebtedness for the purposes of determining how they should be treated in insolvency. Different tests may be developed to facilitate that determination, by focusing, for example, upon the nature of the activity being undertaken, the level of debt and the connection between the debt and the economic activity.” UNCITRAL Legislative Guide, page 39.

<sup>32</sup> <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>.

<sup>33</sup> Ibid.

size of an average MSME in Africa, reportedly between 1-9 people,<sup>34</sup> it is highly unlikely that any value would be left for creditors after such lengthy liquidation proceedings—let alone the possibility of saving the business. The OHADA Insolvency Law is therefore theoretically appealing insofar as it cuts a lot of procedural steps that might not be needed for MSMEs of the size contemplated by that law. Moreover, by allowing the fast-track MSME procedures to be optional, the OHADA insolvency law protects those who are concerned that due process might not be followed, or alternatively, those businesses that have more complex cases and deem it necessary to have additional hearings and judicial oversight. The Southern and Eastern African model may also present an alternative for expedited proceedings, given that the natural person insolvency procedure looks simpler than that for corporations. In the end, the success of both models will largely depend on the specialization of the courts and stakeholders involved in the application of these laws.

*Pre-insolvency procedures are being increasingly recognized as important, particularly for MSMEs*

The recent Regulation (EU) 2015/848 of the European Parliament and of the Council (May 2015) emphasized the importance of pre-insolvency procedures for encouraging business rescue and enabling entrepreneurship. In this sense, IVAs, may be considered effective pre-insolvency procedures and the same can be said about the preventive settlement procedure in the OHADA insolvency law—which is opened, monitored and closed by a judge.<sup>35</sup> Particularly in many African countries, where there are concerns regarding transparency and problems of enforcement, this added institutional force behind the agreed arrangement might encourage the parties to trust and accordingly use the procedure before the business is in a state of insolvency. Of course, the down-side is that this procedure is court-based and therefore public, but there is an additional procedure in the insolvency law which covers contractual conciliation.<sup>36</sup> Another downside is that when the transparency issues affect, precisely, the courts, then the court procedure may not be an advantage for the parties.

In spite of these advancements, there are still areas that are sorely lacking in many African insolvency regimes, which will need to be addressed in order to truly provide an effective insolvency regime for MSMEs. Two examples are as follows: first, most MSMEs in Africa are micro entities operating in the informal sector. It is therefore highly unlikely that any of them will start insolvency proceedings. Secondly, there is a serious lack of financial literacy amongst many entrepreneurs on the continent and access to debt counselling advice is often difficult.

## *Conclusion*

This analysis aims to highlight the importance of MSMEs in African economies, and why insolvency regimes play an important role in ensuring the success of these enterprises. It examines two different methods for handling small business insolvency in various African jurisdictions. Namely, personal bankruptcy regimes that cover natural person insolvency including both consumers and unincorporated enterprises, and insolvency provisions that are simplified from the main commercial insolvency procedure and are applied to certain trade debts (including sole proprietorships). This paper acknowledges that there is currently a lack of data and existing empirical evidence to assess, beyond theoretical considerations, which model is preferable to address MSME insolvency in the regions highlighted in Africa. Moreover, the paper also acknowledges that there are key problems that MSMEs face in Africa that are not addressed by either insolvency regimes, which will continue to impede business start-ups, access to credit and creditor recovery. As stated in the IMF's Regional Economic Outlook for Sub-Saharan Africa, "Over the next 20 years...Sub-Saharan Africa will become the main source of new entrants into the global labour force." It is accordingly crucial that governments have put supporting legislative frameworks in place to support both the entry, restructuring and exit of these businesses, particularly MSME entrepreneurs.

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<sup>34</sup> African Research Associates.

<sup>35</sup> Note, for a pure out-of-court and confidential procedure, the OHADA law provides for conciliation, which is open to all businesses, regardless of size.

<sup>36</sup> As well as *reglement preventif*, the OHADA insolvency law has a pre-insolvency contractually negotiated arrangement called conciliation.

## *Proposal to UNCITRAL on Arbitration & International Insolvency*

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### *I. Introduction*

As international insolvency proceedings become more common, more widespread, and more significant to the world economy, there is a major opportunity for UNCITRAL to provide very significant advice on issues involving the intersection of insolvency law and international arbitration.

The New York Convention / Model Law / Arbitration Rules are effective, universally respected and have stood the test of time. Less clear is the link between the New York Convention / Model Law / Arbitration Rules dispute resolution systems and insolvency systems, which come into play when financial problems of multinational businesses demand resolution. While existing rules and model laws on arbitration and insolvency have created valuable tools fostering international trade, the connection and collision of these regimes should be clarified to the extent necessary to establish a more harmonized and efficient common set of rules.

The purpose of this proposal is to request that UNCITRAL consider undertaking a project on the intersection between international arbitration and international insolvency law and to authorize the assignment of this work to a working group or representatives from more than one working group.

This project would study the impact on a pending arbitration of the commencement of insolvency proceedings by a party to the arbitration. Among the questions that this project should address would be whether, and to what extent, an international arbitration may proceed after the opening of such an insolvency case, and how the arbitration case should interact with (a) the insolvency case and (b) any related insolvency cases that may be opened in other countries respecting the same debtor or the other members of a corporate group of which the insolvency debtor is a member.<sup>1</sup>

This project would also study the question whether a prepetition agreement to arbitrate should be enforced after the commencement of an insolvency case to resolve a dispute between the debtor and a creditor or to determine the monetary value of the creditor's claim in the insolvency case. Countries have taken divergent views on the question whether an agreement to arbitrate is enforceable after an insolvency filing by one of the parties. It would be useful for UNCITRAL to clarify the circumstances under which an agreement to arbitrate, or an arbitral award, should be enforceable even though the award arises in or relates to an insolvency case.

At a later date, UNCITRAL might authorize a study of the use of international arbitration proceedings in international insolvency cases to resolve conflicts between such insolvency cases pending for the same or related debtors in more than one country (such as the Nortel case), where there is no single insolvency court that can take jurisdiction over the entire group of cases.

Each project could result in UNCITRAL recommendations to be published in a Legislative Guide and Explanatory Notes.<sup>2</sup> Perhaps a separate Legislative Guide and set of Explanatory Notes would be useful for these projects.

Each of these projects is urgent because there is no other group that can address these matters as effectively on an international basis,<sup>3</sup> and they have become increasingly important in connection with the

<sup>1</sup> See, e.g., Sara Nadau-Séguin, When Bankruptcy and Arbitration Meet: A look at Recent ICC Practice, 5 No. 1 DISP. RESOL. INT'L 79 (2011).

<sup>2</sup> See Explanatory Note by the UNCITRAL secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006 (published as Part Two of UNCITRAL Model Law on International Commercial Arbitration 1985 with amendments adopted in 2006).

<sup>3</sup> This proposal does not address purely domestic insolvency law and domestic arbitration cases, which can be

reorganization or rehabilitation of financially troubled business entities that are heavily involved in international trade and commerce.

## *II. Background*

International commerce has changed dramatically, particularly in the last 15 to 20 years. In today's world, it is unusual to find a significant financial insolvency or restructuring that does *not* have significant and occasionally critical international aspects. In contrast, international arbitration has a somewhat older and more developed provenance.

In the 19<sup>th</sup> and 20<sup>th</sup> centuries, prior to the New York Convention / Model Law / Arbitration Rules, business financial crises were departmentalized and, for the most part, localized in the countries in which a business had its primary operations. Consequently, the financial difficulties of a business were resolved within national boundaries and under the supervision of a domestic court, which had sufficient jurisdiction and authority to oversee, guide and control all aspects of the company's insolvency or restructuring.

With globalization, all of that has changed. Major businesses have almost universally become globalized with operations in many different countries. For example, Nortel carried on business in 141 countries and Lehman carried on business in even more countries. Under classical territorial insolvency systems, when a financial crisis would hit a parent company and affect its subsidiaries, individual insolvency cases would be opened in many countries where the company or a subsidiary had operations. For instance, that might have involved up to 141 separate insolvency proceedings for the Nortel entities.

Under conventional procedures, each reorganization would have no connection with any of the others, and business between the units of the global enterprise would come to a halt as insolvency cases in each country would open proceedings to take control of the assets in that particular country.<sup>4</sup> Such an approach is not optimal, because economic values of enormous magnitude may be dissipated as a result of the fragmentation of such cases or intercompany disputes may be so expensive that there is far less for distribution to creditors.

The modified universalist insolvency regimes that have largely replaced territorial insolvency systems in most countries, together with the UNCITRAL Model Law on Cross-Border Insolvency, have promoted cooperation among national insolvency cases filed by cross-border entities. UNCITRAL Working Group V is now drafting a model law on the cross-border insolvency of enterprise groups that is expected to further clarify certain of the law in this area.

Nevertheless, any Model Law depends on the discretion of local courts for the implementation of coordination and cooperation provisions relating to international insolvency cases.<sup>5</sup> In addition, there is no international court that can resolve cross-border disputes with finality and certainty.

In our view, international arbitration would provide a valuable tool for resolving cross-border disputes so that prospects for successful reorganizations can be dramatically improved. The New York Convention / Model Law / Arbitration Rules are, in fact, the only way in which international businesses in financial difficulty with serious creditor problems can avoid the worst effects of the international compartmentalization of multinational businesses. The international arbitration system results in arbitral

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regulated by a State's internal law.

<sup>4</sup> This is largely what happened in the Lehman Brothers cases, even though fewer than a hundred of the possible 7,000 insolvency cases were commenced in approximately 20 countries.

<sup>5</sup> While, in form, articles 25 and 26 of the UNCITRAL Model Law on Cross-Border Insolvency mandate cooperation and communication between courts and administrators in international insolvency cases in general terms, the details of such cooperation and communication are left to the discretion of the courts, the administrators and the parties.

awards that are enforceable<sup>6</sup> essentially worldwide.<sup>7</sup> If the general acceptance of the New York Convention can be harnessed to the international insolvency regime, the resulting team can provide a much more powerful international dispute resolution system to deal with the financial crises of international enterprises. In the United States, courts have begun to make use of alternative dispute resolution (“ADR”) techniques, and arbitration in particular, in international insolvency cases. In prominent U.S. bankruptcy cases such as Madoff, General Motors and Enron, U.S. bankruptcy courts have required the use of ADR procedures such as settlement negotiations and mediations. In some cases, the courts have mandated arbitration to be followed by court review de novo if any of the parties refused to accept the award.<sup>8</sup> Indeed, U.S. insolvency law specifically permits an insolvency tribunal, with the express agreement of the parties, to authorize “final and binding arbitration” of “any controversy affecting the estate.”<sup>9</sup> While the use of arbitration in such cases thus far has been limited, there is clearly a growing interest among U.S. bankruptcy judges and insolvency practitioners to use arbitration to resolve complex insolvency disputes where appropriate. Insolvency practice tends to expand the use of ADR gradually from negotiations and mediation to arbitration. The broader international use of such techniques in international insolvency cases could make a major contribution to the success of international insolvency cases.

### III. *A Project to Study the Intersection of Arbitration and Insolvency Law*

If an insolvency case is opened for a party to a pending domestic arbitration proceeding, the domestic insolvency law usually determines whether the arbitration may continue. However, domestic laws often vary as to whether an international arbitration may continue if it violates an insolvency moratorium (or a court order) emanating from the country where the insolvency case is pending.<sup>10</sup>

In most such cases, there is a moratorium under the insolvency law of the country where the insolvency case has been opened. Any attempt by a creditor to arbitrate the dispute may be a violation of the moratorium.<sup>11</sup> However, if the creditor commences arbitration in another country, the court administering the insolvency case may lack any power to punish the violation. In addition, the arbitrator may not even be informed of the pending insolvency case and the applicable moratorium. UNCITRAL’s recommendations should clarify the law in this area, we believe in support of a moratorium on the arbitration.

Even if the arbitration demand is not covered by an insolvency moratorium (for example, because the insolvency law is territorial and the arbitration is outside of the country where the insolvency case is opened, or the creditor demanding arbitration is not covered by the moratorium), the debtor’s power to participate in the arbitration may be substantially impaired. The debtor may have insufficient funds to pursue the arbitration or the insolvency court may refuse permission to the debtor or administrator to spend insolvency estate money (principally belonging to other creditors) on such an arbitration case.<sup>12</sup>

<sup>6</sup> Where proper procedures are followed in structuring an international arbitration, the main impediment to the enforcement of an arbitral award is the public policy of the country where enforcement is sought. *See* NY Convention, art. 5.

<sup>7</sup> At the present time, more than 150 countries (including every active trading country) are parties to the New York Convention on Arbitration.

<sup>8</sup> Edna Sussmann & Jennifer L. Gorski, *Capturing the Benefits of Arbitration for Cross Border Insolvency Disputes*, Arthur W. Rovine (ed.), *Contemporary Issues in International Arbitration and Mediation: the Fordham papers 2013*, Kluwer 2013, 158, 168.

<sup>9</sup> *See* FED. R. BANKR. P. 9019(c). Notably, this rule does not require that the stipulation of the parties be in writing. Typically the stipulation would be made oral in open court on the record, and confirmed with a written court order.

<sup>10</sup> While a moratorium on creditor collection actions in light of a pending insolvency case may result from a court order, the laws of many countries provide for the automatic imposition of a moratorium on creditor collection activities upon the opening of an insolvency case.

<sup>11</sup> The arbitration case may not be in violation of a moratorium resulting from the commencement of an insolvency case in a universalist country. This outcome depends on whether the moratorium covers the dispute to be arbitrated. If, for example, the party requesting the arbitration of a dispute is a secured creditor, and the applicable moratorium does not apply to secured creditors, there is no violation of the moratorium.

<sup>12</sup> A party to an arbitration case is typically required to pay a fee to the arbitration seat for the administration of the arbitration, and to make a deposit for the fees of the arbitrators, as well as to pay its own lawyers to participate

Under the modified universalist view of insolvency law (which is supported in UNCITRAL documents on insolvency law), such an arbitration case should not be permitted to proceed absent authorization from the relevant insolvency court. For such issues, we believe UNCITRAL should clarify the primacy of the insolvency law of the State where the insolvency case is opened, and the circumstances where it is appropriate for the court to permit the arbitration to proceed by vacating or modifying the moratorium

A dispute between a debtor/administrator and a creditor may also arise in an insolvency proceeding where an underlying pre-insolvency agreement contains an arbitration clause. In some circumstances, the insolvency court may consider an arbitration case to be an appropriate method to liquidate the claim, which then becomes allowed in the insolvency case and the creditor receives its pro rata share of the insolvency estate in due course.<sup>13</sup> We believe that the reference of such a dispute to arbitration (especially where the parties are from different countries) should often be authorized under both insolvency law and arbitration law. However, public policy considerations may be involved and a court may conclude that the issue should not be arbitrated under the circumstances. We believe that UNCITRAL's review of the law on this question and its recommendations would be useful to both the insolvency and the arbitration communities.

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in the arbitration).

<sup>13</sup> If such an arbitration case is already in process, the insolvency tribunal may wish to have the parties complete the arbitration to liquidate the claim for the purposes of the insolvency case.

## *Conflict and Consistency in Cross border Insolvency Judgments<sup>1</sup>*

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While business is global, law is local.<sup>2</sup> When a debtor becomes subject to a collective insolvency proceeding that crosses jurisdictional borders, a key factor for the international business community is the extent to which their expectations are met through the interplay of the legal systems involved. Despite efforts since the late twentieth century, there remains uncertainty around the impact of competing insolvency laws on existing rights and interests and party expectations. This affects international trade and commerce as parties assess a jurisdiction's insolvency laws and its capacity to handle cross-border elements as part of their risk assessment in doing business there.<sup>3</sup>

Where an international business is undergoing a cross-border insolvency, differences in domestic insolvency laws can produce different outcomes on a disputed issue depending on where it is litigated. This may lead to local creditors or the foreign representative initiating additional local insolvency proceedings (followed by the commencement of litigation in that jurisdiction), or simply selecting an alternative location to litigate that issue.<sup>4</sup> Litigation of disputes involves a contest between multiple parties, and those other parties will similarly be examining the various jurisdictions in which proceedings to resolve the dispute may properly be commenced, and making forensic decisions based on the likely outcome(s) in each such location.

Domestic insolvency laws which were once drafted to deal with individual traders or single corporate entities must now deal with multiple forms of business association often interwoven into complex business structures and engaged in integrated business and financial operations. In the cross-border sphere, this complexity increases the risk of multi-state parallel litigation.

### *Two examples of Multi-State Parallel Litigation*

The September 2008 collapse of Lehman Brothers, a global financial services firm, with various entities within the group filing in insolvency across numerous jurisdictions, provided challenges to debtors, creditors, regulators and courts alike. This has been so despite the adoption of the UNCITRAL Model Law on Cross-border Insolvency in many of the jurisdictions connected with the case.<sup>5</sup> It is also despite the execution of a Cross-border Insolvency Protocol<sup>6</sup> by the insolvency representatives in many of the proceedings involved.

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<sup>1</sup> The authors acknowledge the contribution and feedback provided on this topic by co-panellists and participants at the International Insolvency Institute Annual Conference, Tokyo, June 2016.

<sup>2</sup> As Lord Millett wrote: "Legal theory, based on the territorial jurisdiction of the courts of the national state, has parted company with the commercial reality and the needs of modern business": 'Cross-Border Insolvency: The Judicial Approach' (1997) 6 *International Insolvency Review* 99.

<sup>3</sup> World Bank, *Doing Business Report 2016*, measures the time, cost, outcome and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency as part of its assessment of countries' business regulation.

<sup>4</sup> For both the commencement of a local insolvency proceeding, and the initiation of litigation, local jurisdictional requirements would need to be met.

<sup>5</sup> For example, the United States of America, the United Kingdom, Japan, Republic of Korea and Australia. Steps were also taken, as permitted under the UNCITRAL Model Law, to communicate by letter between the American Bankruptcy Court and the English High Court: *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] EWHC 2953.

<sup>6</sup> <http://www.ekvandoorne.com/files/CrossBorderProtocol.pdf>.

A key challenge in Lehman was the different domestic law on the effect of ipso facto clauses<sup>7</sup> in an insolvency context, evident in conflicting judgments in parallel legal proceedings issued in the United States and England.<sup>8</sup>

An Australian collateralised debt obligation (“CDO”) beneficiary, Perpetual, commenced proceedings in England against the Trustee to compel distributions, and the same Trustee was also named as a defendant by the Lehman counterparty in proceedings commenced by Lehman in the Bankruptcy Court in New York. The subject matter of the litigation was essentially identical, but the legal framework differed, with only the US Bankruptcy Court obliged to take account of the ipso facto provisions of the US Bankruptcy Code in deciding the case, a consideration which Judge Peck of the US Bankruptcy Court found to be decisive. Lehman was successful in the US proceedings, whereas the opposite outcome was achieved in the UK proceedings. While the sum in dispute in the litigation was measured in the tens of millions of dollars, the authors understand that the outcome would dictate the position on similar CDOs valued in the multiple billions of dollars. The international element, and the inconsistent outcomes it produced, provided a layer of complexity that has added years to the resolution of the substantive issue in dispute, and the inconsistent decisions have to date compelled private settlement through negotiation to resolve the disputes.

The collapse of Nortel Networks, a global networking and telecommunications firm, operating on an integrated global business model has similarly presented unique cross-border challenges. In January 2009, Nortel Network Corp and other Nortel Canadian debtors filed for insolvency protection under Canadian legislation; the United States debtors filed under Chapter 11; and Nortel entities incorporated in Europe, Middle East and Africa were placed in administration in England. It was agreed, by entry into a protocol, to liquidate the group’s assets, including valuable patents, and, in order to improve their value, to resolve entitlement after the sales were completed. The asset sales produced proceeds to be allocated among stakeholders totalling USD7.3billion, representing USD2.85B on account of the sale of business lines, and USD4.5B on account of the sale of residual intellectual property rights. The business lines were sold in 2009 and 2010, and the residual intellectual property was sold in June 2011.

The Protocol required the parties to attempt to reach agreement on the allocation issue, which they did attempt, though unsuccessfully. The allocation issue was then referred for decision (as contemplated by the Protocol) to a joint hearing by both the US and Ontario courts, conducted between May and September 2014.

On 12 May 2015, first instance decisions in the parallel proceedings on the allocation issue were issued by the respective Courts,<sup>9</sup> the effect of which was described by Justice Newbould of the Ontario Superior Court of Justice in the following terms:

“Judge Gross in Wilmington and I have communicated with each other in accordance with the Protocol with a view to determining whether consistent rulings can be made by both Courts. We have come to the conclusion that a consistent ruling can and should be made by both Courts. We have come to this conclusion in the exercise of our independent and exclusive jurisdiction in each of our jurisdictions.”<sup>10</sup>

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<sup>7</sup> That is, contractual provisions to modify the scheme for payment priority. In the United States, the ipso facto clauses were considered unenforceable and any attempt to enforce them would violate the automatic stay: *Lehman Brothers Holding Inc v BNY Corporate Trustee Services Ltd* 422 BR 407 at 421 (Bankr SDNY 2010).

<sup>8</sup> *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] EWHC 1912 (Ch); *Perpetual Trustee Co Ltd v BNY Corporate Trustee Services Ltd* [2009] EWCA Civ 1160; *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38. *Lehman Brothers Holding Inc v BNY Corporate Trustee Services Ltd* 422 BR 407 (Bankr SDNY 2010). The District Court Southern District New York granted a review of Judge Peck’s decision. However pending the appeal, the parties settled. (Note the Bankruptcy Court had directed the parties (422 BR 407 at 423) to attend a status conference to be held for the purposes of exploring means to harmonize the decision of the US and English courts.

<sup>9</sup> *Re Nortel Networks Corporation* [2015] ONSC 2987; *In re Nortel Networks Inc* (Bankr Court, D Delaware, 2015).

<sup>10</sup> *Re Nortel Networks Corporation* [2015] ONSC 2987 at [10].



Appeals were filed in both Canada and the US, though a Canadian Appeal Court<sup>11</sup> later dismissed the leave application to appeal. At the time of writing,<sup>12</sup> the US appeal proceedings are subject to a settlement agreement, but the approval of that settlement is being vigorously contested.

Although consistent decisions were produced by both Courts, the outcome may well have been otherwise. Indeed, if the settlement is not approved, inconsistent decisions may well be the outcome following the appellate process in the US.

One may ask, rhetorically, how would the allocation of the USD7.3B be addressed in this circumstance of ultimately inconsistent final decisions?

It must be acknowledged that the Nortel proceedings are inherently complex, even disregarding the international element. That said, it is perhaps reasonable to infer that the “international element” — the perceived differences in relevant US and Canadian substantive law and the effect of the difference on potential outcomes — has perhaps largely contributed to the dispute resolution process taking the course it took. The USD7.3 billion in proceeds received between 2009 and 2011 has presumably still not been distributed.

Judges involved in the Nortel litigation have expressed views in their respective judgments that suggest the absence of an alternative process of resolution of the international element was problematic, with Justice Newbould declaring “*A global solution in this unprecedented situation is required.*”<sup>13</sup> His Honour described Nortel’s early success in maximising sale proceeds as having “*disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation.*”<sup>14</sup> Elsewhere His Honour refers to the insolvency proceedings having stretched “*over six years at unimaginable expense*”.<sup>15</sup>

Observations of the Third Circuit Court of Appeals in *Re Nortel Networks*,<sup>16</sup> cited with approval by Judge Gross,<sup>17</sup> pointed to a focus by the parties’ lawyers “*on some of the technical differences governing bankruptcy in the various jurisdictions*”<sup>18</sup> as impeding a timely resolution to the dispute. The Court observed that the cost of delay would largely be borne by pension funds,<sup>19</sup> whose members were financially dependent on a very significant component of the USD7.3B tied up by the litigation.

*A problem in need of a solution?*

Amongst other important objectives, and together with other policy imperatives such as timeliness and fairness, insolvency laws seek to achieve an efficient “recycling” of capital.

The international dimension in both Lehman and Nortel very substantially increased the resolution timeline. It appears also self-evident that even in insolvencies of a much more modest size, the existence of an international dimension to a dispute will, of itself, likely produce delays where litigation of the dispute is advanced in multiple jurisdictions. The perspective of the Hon Judge James Peck, the US Bankruptcy Court Judge who presided over the Lehman bankruptcy are illuminating on this issue. In a paper presented after his retirement from the bench, the following observations were offered:<sup>20</sup>

<sup>11</sup> *Re Nortel Networks Corporation* [2016] ONCA 332.

<sup>12</sup> At the time of writing, December 2016, the hearing on confirmation of the Debtors’ chapter 11 plan is scheduled for 24 January 2017.

<sup>13</sup> *Re Nortel Networks Corporation* [2015] ONSC 2987 at [208].

<sup>14</sup> *Re Nortel Networks Corporation* [2015] ONSC 2987 at [208].

<sup>15</sup> *Re Nortel Networks Corporation* [2015] ONSC 2987 at [10]. At [208] his Honour suggested the costs “well exceeded \$1 billion”.

<sup>16</sup> 669 F 3d 128, 143-44 (3d Cir. 2011).

<sup>17</sup> *In re Nortel Networks, Inc.* (Bankr Court, D Delaware, 2015 at [113].

<sup>18</sup> *In re Nortel Networks, Inc.*, 669 F 3d 128, 143-44 (3d Cir. 2011).

<sup>19</sup> “They are the pawns in the moves being made by the Knights and the Rooks.” *Ibid.*, at [144].

<sup>20</sup> “A Cross Border Judicial Dilemma — Conflict and Consistency in Insolvency Cases That Span the Globe”, Hon. James M. Peck; Banking & Financial Services Law Association, Brisbane, 4 September 2015.

“Exercising discretion and applying the law locally is hard enough [for a judge]. Doing so in an international setting “ups the ante” especially when the notional claim amounts exceed \$1 trillion as they did in Lehman.”

According to Judge Peck, where judges involved in multistate parallel litigation faithfully perform their judicial function, this will inevitably on occasions lead to conflicting decisions.

Judge Peck was of the view that “such inconsistent results ... [are] not necessarily a bad thing, nor are such inconsistencies impossible to overcome”.<sup>21</sup> His Honour pointed to the parties achieving consensus through direct negotiation, mediation and arbitration, declaring:

“If there is no effective judicial remedy, parties have no option other than to find a way to agree.”

The authors accept as correct that this reflects the position currently, but do not consider it to be an optimal outcome. Both Lehman and Nortel evidenced that negotiations will not always resolve matters in a timely fashion. Substantial capital is at risk of being tied up for many years by the international element. Indeed, in both cases negotiated outcomes awaited the outcome of the litigation. Secondly, it is legitimate to question whether the interests of justice are well served where, because there is no ultimate judicial outcome, parties have no alternative but to achieve a negotiated solution. In Nortel, and possibly Lehman, significant interest groups were comprised of pension funds. Necessarily, such participants have a shorter term perspective than other participants in the negotiation. This disparity in underlying interest presents at the very least a serious risk that a negotiated outcome will be more reflective of timing imperatives rather than legal merit.

Our view is that the interests of justice compel the conclusion that solutions do now need to be explored to ensure the international element in an insolvency dispute does not unduly delay resolution, or (by virtue of that delay, or the risk of that delay) produce sub-optimal negotiated outcomes.

Various approaches may be taken to avoiding the risk of conflicting judgments on a common issue within a cross-border insolvency. Next this paper outlines these approaches and discusses their success or otherwise in avoiding conflicting judgments.

A number of these approaches involve multilateral bodies, which include the United Nations Commission on International Trade Law (UNCITRAL); the World Bank; and the International Institute for the Unification of Private International Law (UNIDROIT).<sup>22</sup> Professional bodies comprising lawyers, accountants and other professions who advise business on insolvency matters have also engaged with the issues — for example, the International Bar Association (IBA); INSOL International (INSOL); and the International Insolvency Institute (III).

The various responses to these issues can usefully be understood through classifying the different approaches. Some are domestically focussed however most are multilateral in scope initiated by organizations as well as by the transnational community of business leaders and owners, financiers and professional advisers caught up in a particular business failure.

#### *“Judicial Restraint” — Can the Judiciary Avoid the Risk of Inconsistent Decisions?*

The Maxwell case illustrates one approach aimed at avoiding inconsistent judgments. The approach was endorsed by Lord Millett, writing extra-judicially in 1997, who described the approach as the exercise

<sup>21</sup> “A Cross Border Judicial Dilemma — Conflict and Consistency in Insolvency Cases That Span the Globe”, Hon. James M. Peck; Banking & Financial Services Law Association, Brisbane, 4 September 2015.

<sup>22</sup> The Institut International pour l’Unification de Droit Privé (International Institute for the Unification of Private Law) and commonly known as UNIDROIT <http://unidroit.org/> was founded in 1926 and is based in Rome. It is an independent intergovernmental organization whose purpose is “to study needs and methods for modernising, harmonising and co-ordinating private and in particular commercial law as between States and groups of States and to formulate uniform law instruments, principles and rules to achieve those objectives”.

of “judicial restraint”. He discerned three common themes in the English authorities on cross-border insolvency: a need for an international convention and in the meantime, both cooperation between insolvency courts in different jurisdictions, and judicial restraint:

“Pending an international insolvency convention, the basic approach is one of co-operation and judicial restraint. These are two sides of the same coin, and can be accommodated under the heading of judicial comity<sup>23</sup> ...

[In light of Lord Hoffmann’s refusal to grant an anti-suit injunction in the *Maxwell Communications* case, discussed below] ... The normal assumption must be that a foreign judge is the person best qualified to decide whether the proceedings in his court should be allowed to continue. Comity demands a general policy of non-intervention.”

The Maxwell Communications Corporation plc (MCC) cross-border insolvency perhaps represents the high water mark of this approach.<sup>24</sup> At the time of its collapse in 1991, the MCC multinational group consisted of some 400 public companies intertwined with 400 private companies.<sup>25</sup> Assets were located across numerous states, such as Israel, Bulgaria, Germany, Kenya and Canada, which represented a broad spectrum of legal systems.

The group’s principal assets were situated in the United States — some USD700 million to USD1 billion compared to its non-United States’ assets estimated at less than GBP100 million<sup>26</sup> — whereas England was the holding company’s place of incorporation and the group’s place of central management and control. Other significant MCC connections with England were that it traded on the London Stock Exchange, kept its corporate books in pounds sterling and owed most of its USD2.4 billion debt to British banks and London branches of foreign banks.<sup>27</sup>

Two concurrent primary insolvency proceedings were instigated by the MCC Board. On 16 December 1991, they applied in the United States for a debtor-in-possession administration that provided for a creditor moratorium while management structured a Chapter 11 reorganization. On the following day they sought an administration order in England, which would provide a similar stay on creditor action and avoid wrongful trading liability on the part of the directors. An administration order was granted in England on 20 December.

One of the more significant issues that arose was an allegedly voidable transaction with connections to both the United States and England. Shortly before the administrators were appointed in England, MCC had repaid over USD30 million to Barclays Bank plc (Barclays) from the sale proceeds of an American asset. Barclays sought an injunction in England to prevent the administrators from taking recovery action

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<sup>23</sup> Peter Millett, ‘Cross-Border Insolvency: The Judicial Approach’ (1997) 6 *International Insolvency Review* 99 at 103.

<sup>24</sup> It is also a leading example of an approach taken in recent decades to harmonising insolvency systems for the benefit of the debtor and its creditors. In the increasingly global economy of the late twentieth century, the Maxwell case broke new ground in that an Order and Protocol was approved by the courts in separate jurisdictions to case-manage an insolvent international enterprise (or corporate group). Within 16 months a reorganization was in place, a relatively expeditious resolution at the time for a case of that size.

<sup>25</sup> Some of this material draws upon R Mason, ‘Cross-Border Insolvency Law: Where Private International Law and Insolvency Law Meet’ in P Omar (ed), *International Insolvency Law: Themes and Perspectives* (Ashgate, 2008). MCC itself was an English holding company with more than 400 subsidiaries worldwide engaged primarily in information services and electronic publishing, language instruction and general and consumer publishing: Evan Flaschen & Ronald Silverman, ‘Maxwell Communication Corporation plc: The importance of comity and co-operation in resolving international insolvencies’ in E Bruce Leonard & Christopher Besant (eds) *Current Issues in Cross-Border Insolvency and Reorganisations* (Graham & Trotman and International Bar Association, London, 1994) at 41.

<sup>26</sup> *Barclays Bank plc v Homan* [1993] BCLC 680 at 683 [*sub nom Re Maxwell Communications Corp plc (No 2)*] [1992] BCC 757].

<sup>27</sup> Caryn Chittenden, ‘After the Fall of Maxwell Communications: Is the Time Right for a Multinational Insolvency Treaty?’ (1993) 28 *Wake Forest Law Review* 161 at 163.

in the United States. They argued that the action should be determined in England in accordance with English law (under which a defence was available — something not open to them under American avoidance laws).

The English Court of Appeal<sup>28</sup> refused the injunction and upheld the decision of the primary judge (Mr Justice Hoffmann as he then was) that, where the foreign proceedings were not vexatious or oppressive, it was for the foreign court to decide whether or not it was the appropriate forum.

When the preference action was instituted in the United States, the Bankruptcy Court<sup>29</sup> dismissed the proceedings. Subsequently the Second Circuit Court of Appeals<sup>30</sup> also chose to defer to the courts and laws of England, basing its decision instead on the doctrine of international comity precluding the application of the American avoidance law to transfers in which England's interest had primacy.

As suggested above, this case represents the high watermark of “judicial restraint”.

The authors wish clearly to record their view that an entirely unobjectifiable application of domestic substantive law, including conflict of laws principles can lead to judges in other cases declining to stay their own proceedings. There can, for example, be no criticism of either the English or US Courts in the Lehman “flip clause” litigation described above for this concurrent exercise of jurisdiction, given that both Courts had well founded bases for the exercise of local jurisdiction, and for the application of the law applicable in each jurisdiction to determine the dispute. Similarly in Nortel, the complexity of the relevant group insolvency and the respective claims of multiple companies located in different countries rendered the assumption of jurisdiction by both Courts entirely proper. Indeed, it was mandated by the Protocol. The authors respectfully agree with the following observation made by Judge Peck:

“The shared goal of finding a consistent, just and workable solution may conflict with the independent obligation of the trial judge in each Court to decided disputed questions under governing law and procedures. Separate but related insolvency estates necessarily may give rise to irreconcilable separate adjudications”.

While the approach taken on both sides of the Atlantic in Maxwell will provide a solution in some circumstances, other international insolvencies will not present the same opportunity.

### *Uniform Insolvency Laws*

A second approach to avoiding inconsistent judgments is for all states to enact uniform substantive insolvency laws. However, this is not likely to be achieved in any comprehensive manner in the foreseeable future because each state's insolvency laws interact in a complex manner with a range of their other laws.<sup>31</sup> This militates against uniform laws as a solution. However, multilateral bodies with an interest in international trade and commerce have at least promoted convergence of the different domestic insolvency laws.

Model insolvency laws have been drafted with a view to harmonisation, if not uniformity. UNCITRAL produced a *Legislative Guide on Insolvency Law* (2004)<sup>32</sup> which is intended “to be used as a reference by

<sup>28</sup> *Barclays Bank plc v Homan* [1993] BCLC 680.

<sup>29</sup> *Maxwell Communication Corporation plc v Société Generale* 170 BR 800 (Bankr SDNY 1994) affirmed 186 BR 807 (SDNY 1995) and 93 F 3d 1036 (2<sup>nd</sup> Cir 1996). The Court went on to examine choice of law in respect of the avoidance action, holding that English law would apply and, on the basis of comity, decided it should also dismiss the proceedings on that ground.

<sup>30</sup> *Maxwell Communication Corporation plc v Société Generale* 93 F 3d 1036 (2<sup>nd</sup> Cir 1996).

<sup>31</sup> As Professor Fletcher writes “there is a profound and intimate correlation between insolvency ... and the very wellsprings of policy and social order from which national law ultimately draws its inspiration”: Ian F Fletcher, *Insolvency in Private International Law* (Oxford University Press, 2<sup>nd</sup> ed, 2005) at 5.

<sup>32</sup> In 2010 and 2013 guides were added on enterprise group insolvency and directors obligations in the period approaching insolvency.

national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations”.<sup>33</sup> However, UNCITRAL has noted that the rate of adoption of their legislative standards has varied significantly. It has stressed the importance of technical cooperation and assistance by the UNCITRAL Secretariat, because legislative technical assistance, in particular to developing countries, is no less important than the formulation of uniform rules itself.<sup>34</sup>

The World Bank produced their own guidelines entitled *Principles for Effective Insolvency and Creditor Rights Systems* (2005).<sup>35</sup> These Guidelines ‘emphasize contextual integrated solutions and the policy choices involved in developing those solutions’.<sup>36</sup> Significantly, the International Monetary Fund (IMF) and the World Bank at times require bankruptcy reform in developing countries as a condition of loan support, thus promoting the convergence of insolvency law.<sup>37</sup>

States within regional economic groupings have also attempted to arrive at uniform insolvency laws through insolvency treaties. Although never implemented, the first draft *EC Convention on Bankruptcy and Related Matters* (1970)<sup>38</sup> contained draft uniform provisions. It would have required contracting states to enact a ‘Uniform Law’ into domestic law, while permitting states to make reservations on their incorporation.<sup>39</sup>

In 2010, the European Parliament revisited the notion of uniform insolvency laws through its report on the *Harmonisation of Insolvency Law at EU Level*.<sup>40</sup> In November 2016, the European Commission announced a proposed Directive to harmonise laws “on preventative restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures”. It does not seek to harmonise “core aspects of formal insolvency procedures such as conditions for opening insolvency proceedings, definitions of insolvency or ranking of claims”.<sup>41</sup>

The difficulties in achieving universal agreement on substantive provisions are evident in that even these principles and guidelines often contain alternative provisions on important matters of policy. Yet even where there appears to be a common approach on policy, there are often difficulties in achieving uniform enactment and implementation in practice.

In addition to specific insolvency texts, multilateral bodies are drafting Legislative Guides on related commercial topics. UNCITRAL has concluded a number of texts on international trade law issues that have the potential to intersect with insolvency laws. UNCITRAL’s Working Group VI on Security Interests<sup>42</sup> closely collaborated with UNCITRAL’s Working Group V (Insolvency) to produce the *UNCITRAL*

<sup>33</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/2004Guide.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html).

<sup>34</sup> Report of the UNCITRAL General Assembly A/66/17 (44<sup>th</sup> session, 27 June-8 July 2011, New York): <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V11/846/34/PDF/V1184634.pdf?OpenElement>.

<sup>35</sup> These were drafted in 2001 and revised in 2005: *Principles for Effective Insolvency and Creditor Rights Systems* (2005) <http://siteresources.worldbank.org/GILD/Resources/FINAL-ICRPrinciples-March2009.pdf>.

<sup>36</sup> Gordon Johnson, ‘The World Bank’s Consensus Building Role: Developing Principles for Effective Insolvency and Creditor Rights Systems and Related Efforts to Strengthen Capacity’, Paper presented to the *INSOL Sixth World Congress*, London, 2001 at 3.

<sup>37</sup> Hannah Buxbaum, ‘Conflict of Economic Laws: From Sovereignty to Substance’ (2001-2002) 42 *Virginia Journal of International Law* 931 at 946.

<sup>38</sup> Commission Document 3.327/1/XIV/70-E.

<sup>39</sup> Article 76 (1970 Draft).

<sup>40</sup> European Parliament Directorate General for Internal Policies, Policy Department: Legal and Parliamentary Affairs, *Harmonisation of Insolvency Law at EU Level*, 2010 at 6 <http://www.insol-europe.org/eu-research/>.

<sup>41</sup> [http://europa.eu/rapid/press-release\\_MEMO-16-3803\\_en.htm](http://europa.eu/rapid/press-release_MEMO-16-3803_en.htm) “The proposal ... focuses on the key priorities of making sure that effective frameworks for preventive restructuring, insolvency second chance frameworks, as well as discharge procedures are available. In addition, it introduces measures to increase the efficiency — and in particular reduce the length — of all insolvency procedures. The proposal does not harmonise core aspects of formal insolvency procedures such as conditions for opening insolvency proceedings, definitions of insolvency or ranking of claims.”

<sup>42</sup> UNCITRAL Working Group VI on Security Interests has drafted a Model Law on Secured Transactions: [http://www.uncitral.org/uncitral/en/uncitral\\_texts/security/2016Model\\_secured.html](http://www.uncitral.org/uncitral/en/uncitral_texts/security/2016Model_secured.html).

*Legislative Guide on Secured Transactions* (2007).<sup>43</sup> The aim of this project was to ensure coordination of the treatment of security interests in insolvency with the *UNCITRAL Legislative Guide on Insolvency Law*. UNCITRAL cooperated closely with the Permanent Bureau of the Hague Conference on Private International Law.<sup>44</sup> It also coordinated with the International Institute on Private International Law (UNIDROIT) to avoid overlap with its convention on mobile equipment and intermediated securities.<sup>45</sup>

These multilateral efforts provide encouragement that, over time, there will be an increasing convergence of insolvency laws. However, this will take time and is unlikely to achieve uniformity. The authors' view is that while such convergence may eventually reduce the incidence of inconsistent judgments, it will not provide a sufficient solution. Different policy choices (e.g. the presence or absence of ipso facto clause protection) in different states will leave open the opportunity for inconsistent outcomes in the future.

### *Uniform Recognition Laws*

Arguably, States and multilateral organizations have achieved some success in addressing international insolvency through adopting (to greater or lesser extent) uniform laws on recognition of insolvency proceedings and insolvency representatives. This approach accepts a lack of agreement on fundamental issues such as jurisdiction. While there is a consequent likelihood of concurrent insolvency proceedings, it also typically focuses on coordination and cooperation between concurrent proceedings.

A number of States legislate for recognition of and cooperation with foreign insolvency adjudications or proceedings. A familiar example is s 426 *Insolvency Act 1986* (UK), the predecessors for which have been influential in common law jurisdictions with an English legal heritage. Significantly, it authorises the local court to "apply, in relation to any matters specified in the request, the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction."

Multilateral organizations have also investigated avenues to encourage recognition and enforcement. The IBA developed a Model International Insolvency Cooperation Act (1989)<sup>46</sup> and in 1996 approved a Cross-Border Insolvency Concordat that provided some generalised principles to guide harmonising cross-border insolvencies.<sup>47</sup> While courts applied the Concordat in 1997,<sup>48</sup> its use was overtaken by an UNCITRAL initiative.

<sup>43</sup> [http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670\\_Ebook-Guide\\_09-04-10English.pdf](http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf).

<sup>44</sup> They collaborated on the chapter on conflict of laws. The Hague Conference on Private International Law [http://www.hcch.net/index\\_en.php](http://www.hcch.net/index_en.php) is an international organization established in the 19th century to work towards the progressive unification of private international law. It had no success with its 1925 model bankruptcy treaty: Kurt Nadelmann, 'Bankruptcy Treaties' (1943-1944) 93 *University of Pennsylvania Law Review* 58 at 67. In recent years it has concentrated on cross-border cooperation in other civil and commercial matters and insolvency is only mentioned tangentially in a number of texts.

<sup>45</sup> UNIDROIT *Convention on International Interests in Mobile Equipment* (Cape Town, 2001) and UNIDROIT *Convention on Substantive Rules for Intermediated Securities* (Geneva, 2009).

<sup>46</sup> This was a draft model statute for enactment as municipal legislation: Timothy Powers, Rona Mears & John Barrett, 'The Model International Insolvency Co-operation Act' in Leonard & Besant (eds) *Current Issues in Cross-Border Insolvency and Reorganisations*, Graham & Trotman and International Bar Association, London, 1994.

<sup>47</sup> Its first principle was that there should be a single administrative forum that would have primary responsibility for coordinating all relevant insolvency proceedings. However, it did not prescribe a principal forum or seat for the proceeding. It also allowed for concurrent plenary proceedings with coordination, subject in appropriate cases to a governance protocol setting out 'the responsibilities and jurisdiction of each.' Nielsen A, Sigal M & Wagner K, 'The Cross-Border Insolvency Concordat: Principles to Facilitate the Resolution of International Insolvencies' (1996) 70 *American Bankruptcy Law Journal* 533 at 549.

<sup>48</sup> *Everfresh Beverages Inc* litigation, see Leonard EB, 'Committee J's Initiatives in Cross-border Insolvencies and Reorganisations: The Experience of the Everfresh Case' (1997) 6 *International Insolvency Review* 127.



UNCITRAL has promoted uniform recognition laws through states adopting its Model Law on Cross-border Insolvency (1997). At the time of writing, the Model Law has been adopted in 43 jurisdictions.<sup>49</sup> It contains uniform recognition laws — and provides a mechanism for cooperation between jurisdictions and the coordination of concurrent proceedings. However, when adopting it as part of domestic legislation, a State may amend its provisions and so the legislation and the procedures under the Model Law vary from jurisdiction to jurisdiction — sometimes in significant ways.

Finally, in some common law jurisdictions, there are statements to the effect that superior courts may rely upon an inherent jurisdiction to recognize and give effect to foreign insolvency adjudications or proceedings.<sup>50</sup> However in *Rubin v Eurofinance SA; New Cap Reinsurance Corp (in liq) v Grant*,<sup>51</sup> the Supreme Court declined to accept there was a *sui generis* category of insolvency orders or judgments subject to its own special rules.<sup>52</sup> Further, Lord Collins held that “there is nothing to suggest that [Article 21 Model Law] applies to the recognition and enforcement of foreign judgments against third parties.”<sup>53</sup> In light of this uncertainty UNCITRAL Working Group V is working on a draft *Model Law on the Recognition and Enforcement of Insolvency-Related Judgements*.<sup>54</sup>

Meanwhile at the December 2013 meeting of Working Group V, there was discussion of developing an Insolvency Convention, with expressions of support as well as a number of reservations being voiced.<sup>55</sup>

### *Cross-border Insolvency Agreements*

The growing use of CBI Agreements is noted as a response to cross-border insolvency issues, and these are arguably emerging as customary international commercial law.<sup>56</sup> While Article 27 encourages court approval of CBI Agreements to coordinate insolvency proceedings, they predate the Model Law as exemplified in the Maxwell case and subsequent practice.<sup>57</sup> The evolution of the IBA Concordat led to some commentators in the late 1990s describing this practice as an example of customary international law for dealing with cross-border insolvency.<sup>58</sup>

Subsequent developments have borne this out. The practice of parties arriving at ‘in effect’ treaties to resolve cross-border insolvency issues and capturing this in CBI Agreements has been accelerated — most significantly through the Guidelines Applicable to Court-to-Court Communication in Cross-Border Cases published by the American Law Institute (ALI) and ILLI in 2001<sup>59</sup> and 2012;<sup>60</sup> the European Communication

<sup>49</sup> [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html).

<sup>50</sup> *McGrath v Riddell* [2008] UKHL 21 at [30] per Lord Hoffman.

<sup>51</sup> [2012] UKSC 46.

<sup>52</sup> [2012] UKSC 46 at [128] Lord Collins stated “A change in the settled law of the recognition and enforcement of judgments ... has all the hallmarks of legislation, and is a matter for the legislature and not for judicial innovation. The law relating to the enforcement of foreign judgments and the law relating to international insolvency are not areas of law which have in recent times been left to be developed by judge-made law.”

<sup>53</sup> [2012] UKSC 46 at [143].

<sup>54</sup> Working papers are to be found on the UNCITRAL website.

<sup>55</sup> Report of Working Group V (Insolvency Law) (44<sup>th</sup> session, 16-20 December 2013, Vienna): <https://documents-dds-ny.un.org/doc/UNDOC/GEN/V14/001/48/PDF/V1400148.pdf?OpenElement>.

<sup>56</sup> Rosalind Mason, ‘Cross-border insolvency and legal transnationalisation’ (2012) 21(2) *International Insolvency Review* 105.

<sup>57</sup> The 1993 *Olympia & York Realty Company* case (New York and Ontario) — see Peter Millett, ‘Cross-Border Insolvency: The Judicial Approach’ (1997) 6 *International Insolvency Review* 99 at 111 and E Bruce Leonard, ‘The International Scene: The Way Ahead: Protocols in International Insolvency’ (1998) *American Bankruptcy Institute Journal* 191 at 195.

<sup>58</sup> David Culmer, ‘The Cross-Border Insolvency Concordat and Customary International Law: Is It Ripe Yet?’ (1999) 14 *Connecticut Journal of International Law* 563 and Thomas Gaa, ‘Harmonization of International Bankruptcy Law and Practice: Is it possible?’ (1993) 27 *The International Lawyer* 881 at 882.

<sup>59</sup> ALI Transnational Insolvency Project (1993-2000) ‘to provide a non-statutory basis for cooperation in international insolvency cases involving two or more of the NAFTA states, consisting of the United States, Canada, and Mexico’. <http://www.ali.org/doc/Guidelines.pdf>.

<sup>60</sup> The objective of the project undertaken by Professor Ian Fletcher and Professor Bob Wessels was to investigate whether the essential provisions of the ALI Principles of Cooperation among the NAFTA Countries (ALI-NAFTA

& Cooperation Guidelines for Cross-border Insolvency adopted by INSOL Europe in 2008;<sup>61</sup> and the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation of 2009.<sup>62</sup>

The UNCITRAL *Practice Guide on Cross-Border Insolvency Cooperation* (2009) contains information ‘based upon a description of collected experience and practice and focuses on the use and negotiation of cross-border insolvency agreements, providing an analysis of a number of those agreements’.<sup>63</sup> This highlights the significance of a growing international custom around their use.

In its survey of CBI Agreements, the Practice Guide refers to a 1908 British decision<sup>64</sup> in which the court commented that ‘such an agreement is a “proper and common-sense business arrangement to make, and one manifestly for the benefit of all parties interested”’.<sup>65</sup> CBI Agreements typically come into effect through negotiation between the parties and may be presented to courts for review and approval<sup>66</sup> while providing for ‘the independence of the courts’ and affirming ‘the principle of comity’.<sup>67</sup> They have been approved in cases between common law jurisdictions as well as in civil law jurisdictions.<sup>68</sup>

The evolution of CBI Agreements may justify classifying the approach as a customary law of international commercial transactions (or law merchant).<sup>69</sup> This approach does not, however, eliminate the risk of inconsistent judgments in parallel litigation. In both Nortel and Lehman, CBI Agreements were in place (albeit, in the case of Lehman, without the English estate as a signatory). The existence of those CBI Agreements did not prevent the dispute from proceeding in parallel in two states,<sup>70</sup> with the consequence risk of inconsistent judgments, and the associated delay in resolution and potential for sub-optimal negotiated outcomes.

It is considered that the continuing evolution of CBI Agreements is a positive move in the right direction, but not an ultimate solution to the problem.

### *Uniform Choice of Law Rules*

States have achieved more success in addressing cross-border insolvency issues by adopting a uniform approach to choice of law through regional cross-border insolvency treaties or conventions. This has meant that, even with member states’ different domestic insolvency laws, a uniform referral to an applicable local or foreign law<sup>71</sup> should result in the same outcome, regardless of the member state in which the dispute arose. Fletcher and Wessels comment that with uniform choice of law rules “parties’ legitimate expectations

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Principles) and the annexed Guidelines Applicable to Court-to-Court Communication in Cross-border Cases (ALI-NAFTA Guidelines) may, with certain necessary modifications, be acceptable for use by jurisdictions across the world.

<sup>61</sup> Bob Wessels, ‘[European Communication and Cooperation Guidelines for Cross-Border Insolvency](http://www.abiworld.org/committees/newsletters/international/vol4num4/European.html)’ (2007) 4 (4) *ABI Committee News* <http://www.abiworld.org/committees/newsletters/international/vol4num4/European.html>.

<sup>62</sup> [http://www.uncitral.org/pdf/english/texts/insolven/Practice\\_Guide\\_english.pdf](http://www.uncitral.org/pdf/english/texts/insolven/Practice_Guide_english.pdf).

<sup>63</sup> UNCITRAL *Practice Guide on Cross-Border Insolvency Cooperation* 2009, at 1.

<sup>64</sup> *Re P MacFayden & Co* [1908] 1 KB 675.

<sup>65</sup> As such, it exemplified a pragmatic approach by the parties to resolving issues where an insolvent debtor had carried on business through two companies, one located in England and the other in India. UNCITRAL *Practice Guide on Cross-Border Insolvency Cooperation* 2009, at 23.

<sup>66</sup> They agreements between the relevant insolvency representatives need not be ‘approved’ by courts to be effective in practice.

<sup>67</sup> UNCITRAL *Practice Guide on Cross-Border Insolvency Cooperation* 2009, at 32.

<sup>68</sup> For example, the Lehman protocol. Also, see Lucas Daum, ‘The Future of Cross-border Insolvency Protocols’, Leiden Law School November 2009 — Master’s Thesis, Supervisor Professor Bob Wessels; Adjunct Supervisor Honourable Justice James Farley QC, Canada.

<sup>69</sup> Rosalind Mason, ‘Cross-border insolvency and legal transnationalisation’ (2012) 21(2) *International Insolvency Review* 105.

<sup>70</sup> Indeed, the Nortel CBI Agreement mandated the parallel proceedings in the event of the failure of the parties to reach agreement.

<sup>71</sup> Friedrich Juenger, *Choice of Law and Multistate Justice*, Martinus Nijhoff Publishers, Dordrecht, 1993 at 45-6.



can be more consistently fulfilled, thereby reducing the levels of uncertainty and instability that have a key influence on the assessment of risk by those engaging in international transactions”.<sup>72</sup>

The *Nordic Convention on Bankruptcy between Norway, Denmark, Finland, Iceland and Sweden* (1933) recognizes the law of the place of insolvency adjudication<sup>73</sup> as determining almost all the effects of the order in all member states without the need for further formalities.<sup>74</sup>

With effect from 2002, the *EU Insolvency Regulation* (EIR)<sup>75</sup> prima facie applies the law of the ‘home state’ main proceedings to the effects of the insolvency proceedings throughout the applicable European states.<sup>76</sup> A recast Regulation<sup>77</sup> (EIR Recast) will take effect from 26 June 2017 and, subject to any contrary provisions, it likewise applies the insolvency law of the “State of the opening of proceedings” to determining the conditions for the opening of those proceedings, their conduct and their closure.<sup>78</sup> Subsequent provisions address applicable law on specific topics such as third parties’ rights *in rem*; set-off; contracts relating to immoveable property; and acts that are detrimental to all the creditors (e.g. avoidance provisions).<sup>79</sup>

The *UNCITRAL Legislative Guide on Insolvency Law* (2004) contains a small number of draft legislative provisions on applicable law and states: “[b]y specifically addressing, in a transparent and predictable manner, issues of applicable law an insolvency law can assist in providing certainty with respect to the effects of insolvency proceedings on the rights and claims of parties affected by those proceedings”.<sup>80</sup>

In 2012, the ALI and III endorsed the Report, *Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases*,<sup>81</sup> to which were annexed *Global Rules on Conflict-of-Laws*

<sup>72</sup> Ian Fletcher and Bob Wessels, “Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases” (Report, The American Law Institute and the International Insolvency Institute, 30 March 2012) at 20.

<sup>73</sup> This is based on the Convention allocating jurisdiction to a State whose insolvency laws (*lex concursus*) will then take immediate effect, subject to the terms of the Convention, in all the member states.

<sup>74</sup> Article 1 specifies recognition of the divesting of the administration of the debtor’s property; the extent of the assets and the property therein; the bankrupt’s rights and obligations during the bankruptcy; the administration of the bankrupt’s property and transactions in respect thereof; the rights of creditors in respect of the payment of their claims; the allocation of the assets; the composition with creditors or other mode of settlement. There is also an immediate general stay of creditor action: Michael Bogdan, ‘The Nordic Bankruptcy Convention’ in Ziegel JS (ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994 at 702.

<sup>75</sup> EU Insolvency Regulation (1346/2000) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:en:PDF>.

<sup>76</sup> Article 4(1) (EU Regulation on Insolvency Proceedings) states the law applicable to insolvency proceedings and their effects is prima facie the state where such proceedings were opened. The development of the EIR was influenced by the Council of Europe Convention on Certain International Aspects of Bankruptcy (1990). This Istanbul Convention which never came into effect had provided that the applicable law in secondary proceedings was prima facie to be the state where that insolvency proceeding was opened: Article 19.

<sup>77</sup> Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2015.141.01.0019.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.141.01.0019.01.ENG). See Samantha Bewick, “The European Insolvency Regulation Revisited” (2015) *International Insolvency Review* DOI: 10.1002/iir.1240.

<sup>78</sup> Article 7(1) and 7(2) (EU Regulation on Insolvency Proceedings Recast).

<sup>79</sup> While Article 7(2) includes the rules relating to “the voidness, voidability or unenforceability of legal acts detrimental to the general body of creditors” in the list on the conduct of the insolvency, Article 16 states the law of the ‘home state’ law shall not apply if the act is subject to the law of another Member State, which law “does not allow any means of challenging that act in the relevant case”.

<sup>80</sup> UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law* (2004) Pt 2, p. 68. Recommendations 30-34 address the law applicable to the validity and effectiveness of rights and claims, the law applicable in insolvency proceedings and exceptions thereto. These were drafted by UNCITRAL in close cooperation with the Hague Conference on International Law: Fletcher I F and Wessels B, “Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases” (Report, The American Law Institute and the International Insolvency Institute, 30 March 2012) p. 202.

<sup>81</sup> <http://www.iiglobal.org/component/jdownloads/viewdownload/36/5897.html>. The objective of the project undertaken by Professor Ian Fletcher and Professor Bob Wessels was to investigate whether the essential

*Matters in International Insolvency Cases* proposed by the joint reporters, Professor Ian Fletcher and Professor Bob Wessels. It states that these Global Rules were “submitted to ALI and III as a useful starting point for further debate on a global level”. Noting that they had not been tested against existing treaties or conventions, they were proffered instead to:

“serve as legislative recommendations in general and sometimes in more detailed terms. They may also serve as a guide for courts, insolvency practitioners, and creditors in those circumstances where applicable law with regard to international insolvency cases fails to deal with a certain point in issue or is vague.”<sup>82</sup>

The Global Rules provide “a general rule as to the law by which insolvency proceedings and their effects are to be governed” followed by a number of rules continuing exceptions to that general rule in certain defined situations.<sup>83</sup> The reporters specifically endorse three EIR exceptions to the ‘global’ application of the *lex concursus* in respect of third parties’ rights in rem, set-off and detrimental acts.<sup>84</sup>

It is to be noted however that the Global Rules rely upon the *Global Principles for Co-operation in International Insolvency Cases* and its Principle 13 allocating “International Jurisdiction” to open an insolvency case in respect of a debtor when “the debtor’s centre of main interests is situated within the state’s territory”.<sup>85</sup> Global Rule 1 on Scope states that the Global Rules “apply to insolvency proceedings that are opened in a state which has jurisdiction for that purpose according to Global Principle 13.”

Thus, in order to achieve a consistent outcome in cross-border insolvencies, a uniform choice of law approach is inextricably linked with uniformity in choice of forum, that is, agreement upon the allocation of jurisdiction to a primary or other insolvency proceeding.<sup>86</sup>

It may also be observed that the choice of law rules identified in the Global Rules do not represent the only, or most recent, attempt to identify a set of choice of law rules. Despite differences in approach, there is considerable agreement that the law of the COMI should govern most issues. It is, perhaps, the identification of the issues that ought be governed by the law of a different jurisdiction that would benefit from an attempt to achieve consensus within the international legal community. As such, Professor Charles Mooney presents an illuminating alternative approach.<sup>87</sup>

If consensus can be achieved regarding the identification of choice of law rules, followed by their international adoption, it is suggested that the risk of inconsistent judgments will largely be avoided. Such rules, if binding in the relevant states, should produce a unique identification of the law to govern the

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provisions of the ALI Principles of Cooperation among the NAFTA Countries (ALI-NAFTA Principles) and the annexed Guidelines Applicable to Court-to-Court Communication in Cross-border Cases (ALI-NAFTA Guidelines) may, with certain necessary modifications, be acceptable for use by jurisdictions across the world.

<sup>82</sup> Fletcher I F and Wessels B, “Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases” (Report, The American Law Institute and the International Insolvency Institute, 30 March 2012) p. 20. They also state “the main goal [of the Global Rules] is to demonstrate that globally there is a wide measure of support for the enactments of rules of this nature, based on the given principle to avoid miscommunication, to prevent uncertainty, to provide accurate translation, and to ensure smooth cross-border co-operation.”

<sup>83</sup> Fletcher I F and Wessels B, “Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases” (Report, The American Law Institute and the International Insolvency Institute, 30 March 2012) p. 201.

<sup>84</sup> That is Articles 5, 6 and 13 (EIR 2000); Articles 8, 9 and 16 (EIR Recast 2015).

<sup>85</sup> Global Principle 13(1). It also provides for international jurisdiction where “the debtor has an establishment within that state’s territory” however its effects are limited to the assets within the state in question. Global Principle 13(3) defines “center of main interests” (with rebuttable presumptions) and “establishment”.

<sup>86</sup> As the current Working Group V project on facilitating the cross-border insolvency of multinational enterprise groups indicates, this is complicated further for international business enterprises, the UNCITRAL Model Law applying to single debtors (e.g. a corporate entity).

<sup>87</sup> Charles Mooney Jr, “Harmonising Choice-of-Law Rules for International Insolvency Cases: Virtual Territoriality, Virtual Universalism, and the problem of local interests” (2014) 9 *Brooklyn Journal of Corporate, Financial and Commercial Law* 129.

adjudication of the dispute. However, there are, at least two areas where this conclusion may not necessarily follow.

The first is that if such rules do not also include the selection of a unique forum for the resolution of the dispute, there is no guarantee that the dispute, if it advances in parallel in two jurisdictions, will achieve the same outcome even though both jurisdictions apply the same substantive law.<sup>88</sup> To address this risk, the choice of law rules should also include within those rules a binding choice of forum which, in the authors' view, should be the forum whose substantive law is to govern the dispute.

Secondly, in a group context, of which Nortel provides an illustration, the competing claimants were different group companies with different COMIs, adding an additional layer of complexity to the application of choice of law rules. Perhaps any identification of choice of law rules should include within those rules some principles for similarly determining the selection of governing law in a group dispute context (as well as the selection of the forum for determining such a dispute).

### *Is there a role for an international commercial court?*

The existence of uniform choice of law rules does not eliminate the risk of inconsistency if litigation is commenced in two states. The risk of inconsistency will only be avoided where, by reference to the rules, one of the courts stays its own proceedings.

The application by both courts of the same choice of law rules does not avoid the risk of different outcomes on choice of law and choice of forum, for a number of reasons. First, the rules are fact dependent, and each court will decide the issues on the basis of the evidence placed before that court.<sup>89</sup> Secondly, just as different judges in a single jurisdiction may come to different conclusions on agreed facts, so too may the two judges in the different states come to different decisions despite the agreed facts.

It might be thought that the risk of conflicting decisions on the threshold issue of applying the choice of law rules is small. In a statistical sense, this may well be so. However, at a practical level, it is complexity that is perhaps most likely to lead to different decisions on the threshold choice of law and forum issues. It is this same complexity that is likely to render it imperative, in a policy sense, that such inconsistency not lead to the delayed resolution of the substantive dispute.

Could there be a role here for an International Commercial Court (ICC)? The threshold observation to make is that it is not proposed by the authors that the substantive dispute be resolved by an ICC. It is the courts of the state identified by the choice of forum rules that ought resolve the dispute in the authors' view, the forum whose substantive law will govern the dispute. The problem identified in this paper arises where there is a dispute as to the identity of that state. It is here where an ICC can be deployed as the independent tribunal to authoritatively determine at an early stage this preliminary but fundamental issue.

A decision of an ICC, comprised of international judges with an insolvency speciality from independent jurisdictions, is an option that enables a respected and authoritative outcome to the threshold issue. This, in turn, would avoid the prospect of lengthy delays before the substantive litigation can be pursued to resolution. By authoritatively selecting a single jurisdiction, it eliminates the risk of inconsistent decisions. The solution has the advantage of speed, and the number of presiding judges selected to determine the issue could reflect the monetary size of the issue, its legal complexity or its importance. Speed could, for example, be enhanced by appointing a 3 or 5 member bench in lieu of an entitlement to appeal.

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<sup>88</sup> Two judges applying the same law in complex or legally difficult matters frequently reach different conclusions. By way of example, of the 9 English judges who were called on to decide the HIH matter — trial judge, three Courts of Appeal judges and a five member House of Lords panel — 5 judges held that the English assets should be remitted to Australia, whilst 4 judges held that they should not.

<sup>89</sup> A joint hearing may at least remove the risk of inconsistent evidence leading to conflicting decisions.

## *Conclusion*

In summary, the risk of inconsistent judgments from different jurisdictions is a challenging issue to be faced by the debtor, creditors and other parties in a cross-border insolvency. It can produce substantial delays, and may result in sub-optimal outcomes.

A number of ways in which this issue may be approached have been outlined, providing examples of multilateral efforts in recent decades to explore these approaches in practice. The list comprises uniform (or harmonised) insolvency laws, uniform recognition laws, the growing practice around cross-border insolvency agreements, and the adoption of uniform choice of law rules (inextricably linked with issues around choice of forum).

The authors consider that the risk of inconsistent decisions is problematic, and that the existing means for managing the issue, through “judicial restraint” and multilateral efforts to date, do not provide a comprehensive solution. The only way the risk of inconsistent decisions can be avoided is by ensuring there are no multi-state proceedings in respect of the same dispute. Considerable academic work has already been undertaken exploring the option for a comprehensive set of choice of law principles to select, in relation to any dispute with an international element, the law to govern that dispute. The authors’ view is that choice of forum, that is the selection of a single forum, is also a critical part of this solution, and that there may be merit in those rules including a referral to an ICC to address at an early stage any attempt to advance the issue in multiple states.

The authors raise for consideration whether UNCITRAL WGV should explore the achievement of international legal consensus on these issues.

*Cross-border Insolvency and its Threat to International Trade:  
Proposal for a Comprehensive UNCITRAL solution*

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*A. Introduction*

Legal uncertainties that follow from transnational corporate collapses are a major obstacle to the advancement of international trade. Participants cannot predict with certainty the insolvency law(s) that may be applied, and provide for such eventuality. The problem is particularly acute given deep-seated jurisdictional differences in insolvency laws. Attempts at regional and international harmonisation have not to-date found completely viable solutions.

This paper makes the proposition that a viable solution lies in the recognition of the right of companies to select and register (at their inception) the applicable insolvency law. Most jurisdictions today recognize and give effect to the law selected for the company's creation and being. The proposal is an extension of this to the selection of the law by which the company 'dies,' and is supported by the same reasons — it provides certainty that is critical to the facilitation of international trade.

The paper will suggest a convention sponsored by the United Nations Commission on International Trade Law or UNCITRAL (hereinafter referred to as the "**proposed Convention**") that will make the proposal law, with companies having the option of selecting from the national insolvency laws of the jurisdiction of incorporation or the company's centre of main interest (hereinafter referred to as the "**COMI**") or a proposed UNCITRAL Insolvency Law (hereinafter referred to as the "**UNCITRAL Insolvency Law**"). These will complement and supplement the UNCITRAL Model Law on Cross-Border Insolvency (1997) (hereinafter referred to as the "**UNCITRAL Model Law**"). Together they should provide a viable and comprehensive solution to a seemingly intractable problem that is threatening the advancement of international trade.

*B. The problem of cross border insolvency*

The difficulty with most insolvencies these days is that they are not contained within one jurisdiction. In the distant past where companies had their operations, assets and debts within the jurisdiction where they were incorporated, it was completely logical and within the expectations of their creditors that they would be wound up by the laws of that jurisdiction. The rule that the law that creates is that which can "uncreate" remains the conflicts rule of most jurisdictions today.

Increasingly however companies operate, have their assets and creditors in several countries beyond their jurisdiction of incorporation. Many jurisdictions have responded to this by legislating to confer on their courts the right to wind up foreign companies. Potentially proceedings to wind up the company may be opened in all the jurisdictions in which the company has some connection.

Jurisdictions are wont to exercise jurisdiction on increasingly thin connection resulting in proliferation of insolvency proceedings. The concern with multiplicity of proceedings has mostly been with larger costs and smaller returns, not inevitable but common, and the problem of recognition and enforcement of orders by courts that are not of the jurisdiction of incorporation. These have been addressed with considerable success by the UNCITRAL Model Law and the EU Insolvency Regulation.<sup>1</sup>

There is however another seemingly intractable problem that affects more directly advancements in international trade. Multiplicity of proceedings almost invariably means a multiplicity of insolvency laws since courts mostly apply the *lex fori* (law of the forum) for insolvency matters. This stands in the way of *ex ante* predictability for creditors as to the applicable insolvency law that is critical to the pricing of risk, and provision against it. The consequence of this is often increased cost of capital for the debtor.

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<sup>1</sup> Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

That is the problem of conflict of laws that remains to be addressed in a viable way, and which this paper seeks to suggest a solution for.

### C. Existing instruments dealing with cross border insolvency

Efforts have been made at international, regional and domestic<sup>2</sup> levels to address the cross border issues most of which are focused on recognition and cooperation. Amongst them the UNCITRAL Model Law and the EU Insolvency Regulation have had the greatest impact. The former is a non-binding international initiative by UNCITRAL which allows for free divergence by those adopting it, whilst the latter is binding legislation of the EU Member States, with limited divergence permitted. Both implement a system of modified universalism.<sup>3</sup>

The UNCITRAL Model Law facilitates the recognition of foreign insolvency proceedings by mandating and encouraging cooperation and coordination to varying degrees depending on whether the proceedings are “main” or “non-main”. It does not deal with the conflicts issues of jurisdiction and applicable law but is predicated upon jurisdiction to open main insolvency proceedings being with the COMI of the company,<sup>4</sup> and non-main proceedings where the company has an establishment.<sup>5</sup> It does not, whether directly or indirectly, provide for the law applicable to the proceedings.

The EU Insolvency Regulation legislated for both jurisdiction to open insolvency proceedings and the law applicable thereto. For the Member States of the European Union, jurisdiction to open main proceedings is vested in the courts of the COMI as defined in the recast of 20 May 2015.<sup>6</sup> Secondary proceedings are permitted where the debtor possesses an establishment<sup>7</sup>, restricted to the assets located in those jurisdictions. The applicable law is the *lex concursus* or *lex fori*, being the insolvency laws of the COMI or the particular secondary proceedings as the case maybe.<sup>8</sup>

It may be thought that extending the EU Insolvency Regulation’s treatment of the conflicts issues outside of the European Union will resolve the problem for the rest of the world. The following section will demonstrate why it will not provide a completely viable solution.

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<sup>2</sup> There are national laws that deal with insolvencies with cross border elements and bilateral and multilateral agreements between nations to moderate cross border insolvencies, see Ian Fletcher, *Insolvency in Private International Law* (2<sup>nd</sup> edn), chaps 5-8. These are specific to the contracting parties and or of limited application and are not considered here.

<sup>3</sup> This is not totally uncontroverted. Franken, “*Cross-Border Insolvency Law: A Comparative Institutional Analysis*” 92(14) 34(1) *Oxford Journal of Legal Studies* 97, at p116 suggested that the Model Law essentially offers a cooperative territorial approach to cross border insolvency law. LoPucki, “*Universalism Unravels*” (2005) 79(1) *American Bankruptcy Law Journal* 143, p. 166 on the other hand suggested that it is a form of backdoor universalism. The EU Insolvency Regulation has been said to embody a modified version of territorialism: Horst Eidenmuller, “*Free Choice in International Company Insolvency Law in Europe*” *European Business Organization Law Review* (2005) 423, at p. 433.

<sup>4</sup> There is a rebuttable presumption that the COMI and place of incorporation are the same, art 16(3).

<sup>5</sup> See for example art 17 (2).

<sup>6</sup> Regulation(EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast). Unless stated to the contrary, references in this paper will be to the provisions under the 2015 EU Insolvency Regulation recast much of which will come into force on 26 June 2017.

<sup>7</sup> Art 3(2): Courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if it possesses an establishment within the territory of that other Member State. Art 2 defines ‘establishment’ to mean any place of operations where a debtor carries out or has carried out in the 3-month period prior to the request to open main insolvency proceedings a non-transitory economic activity with human means and assets.

<sup>8</sup> Art 7(1): Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened... See also Recital 66. It is commonly thought or assumed that in an insolvency context the choice of law should follow from the choice of forum. See for e.g., Rasmussen, “*A New Approach to Transnational Insolvencies*” 19 *Mich. J. Int’l L.* (1997)1, at p. 33.

#### D. Predictability under the EU Insolvency Regulation

The EU Insolvency Regulation's treatment of the applicable insolvency law is deceptively simple. It is the law of the jurisdiction where insolvency proceedings, whether main or secondary, have been opened, or the *lex consursus*.<sup>9</sup> At first blush the approach is very attractive. The forum of the proceedings should have no difficulty identifying the law, or applying it, as it is also the *lex fori* or the law of the forum.

The difficulty with legislating for the *lex consursus* is that the law is only identifiable when the forum for insolvency proceedings is established. Whilst the EU Insolvency Regulation points to where these should be, they are not always readily identifiable, particularly in advance of the proceedings. This is notwithstanding the definition of COMI under the recast.

The recast has legislated that "The centre of main interests shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties."<sup>10</sup> Recital 28 states that special consideration should be given to the perception of creditors.

Where the debtor has its operations, assets and creditors in a number of jurisdictions it is unclear by which creditor(s) assessment ascertainability is to be made. What is ascertainable is often dependant on where the creditor is. Many companies these days operate through the internet. The COMI of these companies would be inscrutable to third parties. Ironically the qualification intended to enhance predictability may potentially make the COMI, and hence the applicable law of the main proceedings less predictable.

As and when secondary proceedings are opened, their laws will substitute for the law of the COMI in relation to assets within their territory. Since these secondary proceedings cannot be determined in advance creditors would need to inform themselves *ex ante* of the insolvency laws of every jurisdiction where the debtor has an establishment which may potentially be the venue of secondary proceedings in order to price the risk. The alternative would be to assess the risk on the basis that they would open secondary proceedings in a particular jurisdiction.

Whilst the EU Insolvency Regulation has gone a long way in regulating cross border insolvencies for its Member States, predictability of the applicable law remains problematic, even with the improvements of the recast. It does not provide the ideal blueprint for a global solution to a more predictable applicable law.

#### E. Predictability with a choice regime

*Ex ante* predictability, it will be demonstrated, is better achieved by allowing companies to select the applicable insolvency law. The company designates at its inception the insolvency law that will apply in the event it subsequently becomes insolvent. This is the choice by which it is bound, and it is a choice that is made public in its constitution (and the registry of its incorporation). The company's insolvency law, like the law of its incorporation, will then be certain and readily ascertainable in advance by those dealing with the company.

The proposal is not as radical as it may appear at first blush to be. Most jurisdictions today recognize and give effect to the law selected for the company's creation and being. The proposal is but an extension of that to the selection of the law by which the company 'dies.'

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<sup>9</sup> With limited exceptions for *in rem* rights and employment contracts.

<sup>10</sup> Article 3(1). These are also the principal elements of COMI suggested by the Revised UNCITRAL Model Law Enactment Guide.

There are however greater social implications to the choice of insolvency law than that of incorporation. This is why the proposal does not advocate complete freedom of selection (as proponents of the free choice regime have mostly suggested)<sup>11</sup> but a choice from amongst the following three laws:

1. The insolvency law of the jurisdiction of incorporation
2. The COMI's insolvency law
3. The UNCITRAL Insolvency Law

The first and second of these are not controversial options. The jurisdiction of incorporation and COMI are widely regarded as the jurisdictions whose insolvency laws should apply. The third provides a neutral law specifically tailored to address cross border insolvency issues. It is envisaged that the UNCITRAL Insolvency Law will reflect an acceptable balance between the pro-creditor and pro-debtor approaches.

A more conservative approach would perhaps omit the UNCITRAL Insolvency Law but the writer sees value in its inclusion. This will allow companies to choose a better conceived insolvency law tailored specifically to deal with cross border insolvencies which may potentially encourage national lawmakers to model their insolvency laws after it.

Conversely it is possible to provide choices of more than the three. For group enterprises this could include the insolvency laws of the holding company's jurisdiction of incorporation or COMI. This will enable group companies to align the applicable insolvency regime with the group's organization structure and operations. The choice should nevertheless be made separately for each company within the group.

The extent of the selection menu can be finalised after consultation to gauge what is acceptable to stakeholders. Consideration should also be made for a default choice where none is specified. This, it is suggested, should be the insolvency laws of the COMI for EU Member States and that of the jurisdiction of incorporation for others.

The considerations for making these laws available to companies for selection are discussed in the following sections.

#### *F. Insolvency law of the jurisdiction of incorporation*

The insolvency law of the jurisdiction of incorporation is inherently appropriate to the winding up of the insolvent company. The company, being a legal person, is created by the law of its incorporation and it is that law that can remove its existence or 'uncreate' it.

There are also reasons why it is a viable choice for *ex ante* predictability. The jurisdiction of incorporation is ascertainable, most importantly, in advance. It is almost always a single jurisdiction and consequently selects a single insolvency law. Multiple incorporations and re-incorporations are rare. If the jurisdiction of incorporation is selected which subsequently moves to another this is a process normally allowed with adequate publicity and consideration of affected creditors. In the case of multiple jurisdictions of incorporation (which is very rare), the company will select the one whose insolvency laws will apply.

The insolvency laws of the place of incorporation is an appropriate law even for Delaware-type companies where the company's assets and business are outside the jurisdiction of incorporation. Strictly

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<sup>11</sup> The freedom of choice of insolvency regime is not in itself new. Various models of free choice have been suggested by their proponents who have advanced it as a rival principle to universalism and territorialism. The free choice approaches vary from complete/unrestrained freedom to write bankruptcy contracts or select bankruptcy systems to the choice of forum to choice between having either one or multiple insolvency proceedings. See for example Rasmussen "A New Approach to Transnational Insolvencies" 19 Mich. J. Int'l L. (1997) 1; E Warren, "Bankruptcy Policymaking in an Imperfect World" 92 Mich. J. Int'l L. (1994) 336, pp. 385-386 and Alan Schwartz, "Bankruptcy Contracting Reviewed" (1999) Yale Law Journal Vol 109, 343.



the jurisdiction of incorporation alone has the law that is able to wind up the company (as opposed to merely liquidating its assets). This is regardless of where the company's assets and business are.

It may of course be more efficient for the insolvency proceedings of Delaware-type companies to be opened where the assets and business are, as the English court thought in *Re Harrods*.<sup>12</sup> The company, under the proposal, has the option to select the COMI's insolvency law instead or indeed the UNCITRAL Insolvency Law. But if it does select the law of the jurisdiction of incorporation there is no reason for creditors to complain, having chosen to deal with a company created under those laws.

#### G. COMI's insolvency law

The COMI's insolvency law should be an available option as the COMI is that vested with jurisdiction under the EU Insolvency Regulation, and the UNCITRAL Model Law's approach is predicated upon that. Its omission would effectively mean the exclusion of EU Member States' participation in the proposed Convention. Conversely its inclusion allows EU Member States to participate in the proposed Convention beyond the regional legislation and without compromising its policies.

The proposed Convention's definition of COMI should be aligned to that under the recast of the EU Insolvency Regulation to facilitate participation by EU Member States. Companies that have their COMI within the EU are effectively limited in their selection to the insolvency law of the COMI. This can be achieved by allowing the ratification of the proposed Convention subject to the condition that it shall apply to EU Member States only where the COMI's insolvency law is selected. Creditors are not prejudiced since it is the EU COMI's insolvency laws that will apply under the EU Insolvency Regulation.

Whether there should additionally be a right to state a group COMI to supplement group coordinated proceedings introduced by the EU Insolvency Regulation recast<sup>13</sup> is a matter for further consideration. In group enterprises where the operations of the subsidiaries are fully integrated with the holding company's the COMI may well lie with the holding company, but this may not be the case where the entities within the group have independent businesses. These matters are not readily ascertainable by third parties, and is better left to the group enterprise to determine and declare.<sup>14</sup>

The application of the same law to the insolvency of related companies of the group would go some way to address the insolvency problem of group enterprises. It will enable proceedings with respect to companies belonging to the same group to be conducted under the same set of insolvency laws and rules. This is likely to lead to more efficient outcomes where the group's organizational structure and operations are integrated.

#### H. The UNCITRAL Insolvency Law

The UNCITRAL Insolvency Law will provide a modern, coherent and comprehensive cross border insolvency regime that is well suited to dealing with the consequences and complexities of cross border insolvencies. The UNCITRAL Legislative Guide on Insolvency Law would be a good reference for the crafting of the Law, with adjustments tailored to address more specifically the cross border issues.

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<sup>12</sup> when it sent an English company to be wound up in Argentina where it had all its assets and business: *Re Harrods (Buenos Aires) Ltd* [1992] Ch 72

<sup>13</sup> Chapter 5.

<sup>14</sup> Enterprise groups are an increasingly common business vehicle. Since the companies within the group are connected in some way, the collapse of one would frequently lead to the insolvency of others within the group, and we have witnessed many of these in the last decade. Much of the efforts relating to the treatment of companies in insolvency however deal with the single corporate entity, or do not properly distinguish the insolvency of a single corporate entity from the insolvency problems of a group enterprise. They do not specify whether the COMI is determined for each company within the group, for the group enterprise as a whole, or the insolvent companies within the group.

The company's choice of this Law would mean that there is no connection whether by assets, establishment or law but this is not a problem. Since the UNCITRAL Insolvency Law is not the law of any particular jurisdiction it in fact allows the insolvency proceedings to be opened unhindered in the jurisdictions where it would be efficient to do so. These may well be those traditionally thought to be the jurisdictions of the main and secondary proceedings.

If the UNCITRAL Insolvency Law proves to be a popular choice this would send positive signals to national lawmakers to model their insolvency laws after it. This will lead to greater convergence of insolvency laws and their underlying policies.

#### *I. Mechanism and timing for choice*

The choice would be made at incorporation and reflected in the constitution of the company. The COMI should be identified if its insolvency law is selected to provide clarity and transparency. The publicly declared COMI should satisfy the requirement of the EU Regulation recast that the centre of administration be ascertainable by third parties.

The timing of the choice (at incorporation) when the interests of the company are aligned to those of its creditors and investors will ensure that the choice is not made to prejudice them.<sup>15</sup> It also reduces risk shifting to involuntary and small or less sophisticated creditors. The risk of manipulative conduct is in any event small given the limited choices of applicable insolvency laws.

#### *J. Alteration of choice*

Companies should be bound by their choice of the insolvency law of the jurisdiction of incorporation or COMI or the UNCITRAL Insolvency Law. To allow switches from one category to another would be to reintroduce uncertainty. Alterations, if they are to be permitted at all, should be limited to changes to the company's jurisdiction of incorporation (e.g. by way of reincorporation of companies and/or mergers and amalgamations) and COMI. It follows from this that the selection of the UNCITRAL Insolvency Law cannot be changed, nor the law of the COMI or jurisdiction of incorporation without an actual change to those places.

Entrenching choices provide for greater certainty but clearly exceptions can and should be made as thought appropriate. Mechanisms will have to be put in place to safeguard against opportunistic changes such as changes on the eve of insolvency. It may be that processes involved in re-incorporations already provide sufficient protection.

#### *K. Jurisdiction for opening of insolvency proceedings*

The selection of the applicable law brings with it a preference for the jurisdiction of the applicable law, and their courts to have conduct of the insolvency proceedings. That would in most part be the most efficient. The proposal does not however make this a requirement. Secondary proceedings may be opened in jurisdictions where assets are located which are not the jurisdiction whose law is applicable to the insolvency proceedings. Where the company (or its group) has assets and businesses in diverse jurisdictions secondary proceedings would facilitate a speedier and less costly administration.

The main proceedings have universal scope, and encompass for purposes of distribution, all the debtor's assets, including those remitted from secondary proceedings. The administration of the secondary proceedings is limited to the collection of assets of the debtor within that jurisdiction and to their remittance to the liquidator of the main proceedings.

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<sup>15</sup> Indeed, because they need to attract capital and other sources of funds, they are more likely to make choices that offer better protection to creditors and investors. The deterrence against companies choosing overly debtor - protective insolvency laws would be the higher cost of capital and credit.

As the role of the secondary proceedings is limited, arguments that courts are best equipped to apply the insolvency laws of their own jurisdiction should not stand in the way of the proposal. The separate insolvency proceedings are merely mechanisms for the more convenient collection of assets which are then remitted to the liquidator in the main proceedings.<sup>16</sup> Having the assets administered separately this way will not raise the spectre of inefficient deployment of those assets.

To achieve a *pari passu* distribution between all of the debtor's creditors worldwide it is necessary for the pooling of all its assets wherever located and for distribution to be declared out of that pool and by the same set of rules.<sup>17</sup> This may however result in some creditors losing their preferential status or ranking lower because of differences in distribution rules.<sup>18</sup> If there is a strong preference for distributive choices of local laws, then consideration may be made to make an exception for them so that the liquidators of local secondary proceedings can pay off preferential debts before remitting the remaining assets to the jurisdiction of the main proceedings.<sup>19</sup>

The application of a single insolvency law to the main and secondary proceedings will remove an incentive to open proceedings outside of the main to take advantage of another insolvency law. This disincentive against forum shopping should consequently reduce the number of secondary proceedings to those that would actually facilitate distribution of assets within their jurisdiction.

The court competent for the main insolvency proceedings should be able to order provisional and protective measures under the applicable law covering assets situated anywhere. Whether it should additionally be possible for the liquidator to apply for the preservation measures under the law of the jurisdictions of the secondary proceedings is a matter for further consideration.

#### *L. Addressing objections to a choice regime*

The free choice regime in all the manifestations suggested by their proponents remains very much in the shadows of the more established universalism and territorialism. It has not been seriously considered as providing a viable alternative to universalism and territorialism. On the contrary it has been called a radical proposal with close to no political implementation chances.<sup>20</sup>

Objections to the free choice regime centre on the company choosing a law detrimental to its creditors. The company, it is said, is likely to select a law that is pro-debtor to the detriment of all creditors. A variant of this objection points to a choice detrimental to tort victims specifically. Tort victims are said to be particularly vulnerable as they suffer the risks without the benefits. Since involuntary creditors do not choose their debtors the ability to predict the applicable law is not seen to be an advantage. Proponents of the free choice regime have responded to these criticisms with suggestions of either special treatment for tort victims or excepting them from the chosen law.<sup>21</sup>

Restricting choice in the way of the proposal should largely address any risk of manipulative conduct whether detrimental to all creditors or just tort victims. As the laws of the jurisdiction of incorporation and COMI are those most likely to apply in the company's insolvency the selection of either should not provide

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<sup>16</sup> This is essentially a universalism approach.

<sup>17</sup> Which is what the common law envisages to be the function of ancillary proceedings. See *Re Bank of Credit and Commerce International SA (No 10)* [1997] Ch 213.

<sup>18</sup> The reverse could also occur.

<sup>19</sup> Efforts aimed at universalist regimes have largely failed because of differences in distribution rules particularly if they affect priority rights to taxes.

<sup>20</sup> Horst Eidenmüller, "Free Choice in International Company Insolvency Law in Europe" *European Business Organization Law Review* (2005) 423, at pp. 433, 441-442.

<sup>21</sup> See Rasmussen, "A New Approach to Transnational Insolvencies" 19 *Mich. J. Int'l L.* (1997)1, at pp. 34-35 where he made the proposition in relation to the choice of forum that "weak" creditors receive at least the same treatment that they would have at their home jurisdiction. See also the arguments against that in Horst Eidenmüller, "Free Choice in International Company Insolvency Law in Europe" *European Business Organization Law Review* (2005) 423, at p. 437.

an advantage to the debtor. The UNCITRAL Insolvency Law is intended to be neutral in its approach and should not tilt the balance either way.

Special treatment for tort victims whether by way of exception to the applicable law or something else is therefore unnecessary. To accord special treatment may conversely give them an advantage that they do not currently have.

The writer's proposal may in fact reduce manipulative conduct since the company is bound by its selection. Currently debtors are able to make eve-of -insolvency manoeuvres to change the applicable law.

#### *M. Proposal implementation*

This paper has set out the basic framework and principal considerations of the writer's proposal. Clearly more than these have to be considered for its actual implementation. Aside from the issues already considered, and those flagged for further consideration, there will also be a need to decide *inter alia* on the type of insolvency proceedings to be covered,<sup>22</sup> the scope and application of the selected law<sup>23</sup> and its application to existing companies.<sup>24</sup>

It is critical to the proposal's viability that it be adopted widely. To ensure that the proposal will facilitate and not exclude participation of the EU Member States the proposal has included the COMI's law as an option and aligned the COMI to that of the EU COMI as defined in the 2015 recast of the EU Insolvency Regulation. There will be a need to comb through the EU Insolvency Regulation and 2015 recast thoroughly to identify any potential conflicts that should be dealt with before the proposal is made definitive.

This paper has suggested that the proposal be implemented by a convention sponsored by UNCITRAL. The proposal requires complete uniformity of treatment of the conflicts rule and reciprocity amongst contracting states, and this is only achievable by a binding instrument. Whilst the UNCITRAL Model Law has achieved a high degree of international uniformity in the jurisdictions where it has been implemented it has not been complete uniformity.

Thus far UNCITRAL's efforts in relation to cross border insolvency have been by non-binding instruments in recognition of the fact that nations are unlikely to commit to a binding regime because of deeply held divergences in their insolvency laws. The proposal does not require changes to national insolvency laws or reflect a preference for any of them. This should increase acceptability of the proposal and its implementation by binding instrument since it does not involve resolving differences between them.<sup>25</sup>

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<sup>22</sup> The UNCITRAL Model Law applies to collective insolvency proceedings whose purpose is the reorganization or liquidation of the debtor, and where the assets and affairs of the debtor are subject to court control or supervision, see art 2(a). The EU Insolvency Regulation's scope is wider under the recast, covering rescue, adjustment of debt, reorganization and liquidation: see art 1. In principle the proposal is capable of the wider application but its scope has of course to take into account what is acceptable to most jurisdictions.

<sup>23</sup> Should it govern every aspect of the debtor's affairs, or should its application be restricted to matters usually regulated by insolvency laws such as administration of the assets, priority ranking among creditors, stay of enforcement rights, and clawbacks (avoidance)? Should exceptions be made for in rem rights and employment contracts, as have been made by the EU Insolvency Regulation? There's also the related question of whether criminal sanctions should be confined to that of the chosen law.

<sup>24</sup> Since the applicable insolvency law is selected at the company's incorporation this will effectively exclude existing companies unless a mechanism for selection is made for them specifically. The writer's preference is to confine the choice regime to new companies as a choice mid-life will interfere with expectations of creditors and investors of the company. Whilst it may well be possible to craft Convention rules to provide against abuses the treatment of it will be complex. It is also anticipated that this will give rise to objections on policy grounds that will make the proposed Convention less attractive to stakeholders.

<sup>25</sup> There is little prospect of reaching agreement on resolving differences between national insolvency laws. The divergences are too extensive and deep-seated.

The proposal recognizes the centrality of cross border cooperation. Liquidators of the main and secondary proceedings should observe proper cooperation in accordance with the relevant guidelines of the UNCITRAL Model Law. These could be incorporated into the proposed Convention directly or by reference.

The UNCITRAL Insolvency Law will provide a non-national insolvency law option specifically tailored for cross border insolvencies that is modern, coherent and comprehensive, and balanced as to the protection of creditor and debtor.<sup>26</sup> The text of the UNCITRAL Insolvency Law will be appended to the proposed Convention, and companies will be able to select it as their applicable insolvency law.

The UNCITRAL Insolvency Law may potentially influence the shape and content of national insolvency laws. If it is widely selected it will create an incentive for national lawmakers to model their insolvency laws after it, or at least some of its rules. This will pave the way to greater convergence in insolvency laws and their underlying policies.

The proposed Convention is not intended to supersede but to complement and supplement existing efforts of UNCITRAL and the 2015 recast of the EU Insolvency Regulation. Together they should provide a viable and comprehensive solution to the seemingly intractable problem of cross border insolvencies that is threatening the advancement of international trade.

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<sup>26</sup> The UNCITRAL Legislative Guide on Insolvency Law will provide a reference for the drafting of the UNCITRAL Insolvency Law with adjustments to address the consequences of cross border insolvencies.

## *Reflexiones sobre la unificación de las normas de Derecho internacional privado aplicables a los procedimientos de insolvencia transfronteriza*

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### *Introducción*

1. La codificación del Derecho de la insolvencia transfronteriza refleja una tendencia hacia una progresiva *armonización* a través de la utilización de la técnica metodológica del *soft law*. Pese a que parte de la doctrina discute su valor normativo<sup>1</sup>, lo cierto es que el grado de flexibilidad que aporta el *soft law* permite alcanzar cierta uniformidad en la regulación de la insolvencia transfronteriza, no exenta de limitación debido al particularismo de los Estados y a la ausencia de carácter vinculante<sup>2</sup>.
2. Desde la perspectiva del Derecho internacional privado, el presupuesto origen de este planteamiento cabe situarlo en la diversidad y pluralidad de ordenamientos jurídicos nacionales (tanto *Derecho sustantivo* como *procesal*) aplicables a la institución de la insolvencia, lo cual dificulta la elaboración de un “*Derecho concursal internacional uniforme*”<sup>3</sup>. No obstante, resulta imposible la regulación de las normas de Derecho internacional privado a través del *soft law*, siendo el tratado internacional la técnica metodológica perfecta para el proceso de unificación de las normas conflictuales.
3. El objeto del presente estudio es analizar, en primer lugar, cuáles son los antecedentes e hitos más importantes en el proceso de codificación del Derecho de la insolvencia transfronteriza y cuál ha sido el papel que en este proceso ha desempeñado la Comisión de las Naciones Unidas para el Derecho Mercantil Internacional (en adelante UNCITRAL) en el ámbito universal (*cfr. epígrafe I infra*). El autor propone de *lege ferenda* la elaboración de instrumentos vinculantes de ámbito universal para la *unificación* de las reglas que resuelvan el conflicto de leyes y de jurisdicción en el Derecho concursal internacional (*cfr. epígrafe II infra*).

#### *I. La codificación del Derecho de la insolvencia transfronteriza: armonización versus unificación.*

4. Analizaremos en primer lugar cuáles han sido los antecedentes históricos más importantes en el proceso de codificación del Derecho de la insolvencia transfronteriza (*cfr. epígrafe A infra*) y cuál ha sido el papel que en este proceso ha desempeñado UNCITRAL en el ámbito universal (*cfr. epígrafe B infra*).

##### *A) Antecedentes históricos en el proceso de codificación del Derecho de la insolvencia transfronteriza.*

5. Con independencia de la previa existencia de algunos tratados bilaterales o multilaterales que ya recogían disposiciones sobre la quiebra<sup>4</sup>, el primer intento de codificación de un texto en el ámbito universal en materia de insolvencia transfronteriza tuvo lugar con un proyecto de convención

<sup>1</sup> A. BOUVERESSE, “La portée normative de la soft law”, *Revue du marché commun et de l’Union Européenne*, núm. 588, 2015, pp. 291-298.

<sup>2</sup> J.C. FERNÁNDEZ ROZAS, R. ARENAS GARCÍA y P. A. DE MIGUEL ASENSIO, *Derecho de los negocios internacionales*, Iustel, 3ª edición, Madrid, 2011, pp. 62-75.

<sup>3</sup> A. L. CALVO CARAVACA y J. CARRASCOSA GONZÁLEZ, *Derecho concursal internacional*, Colex, Madrid, 2004, pp. 16-17.

<sup>4</sup> El primer tratado multilateral de ámbito regional que recoge normas sobre quiebras es el Tratado de Montevideo de Derecho Mercantil Internacional de 1889, posteriormente revisado en 1940. Sobre estos antecedentes, *cfr.* K. NADELMANN, “Bankruptcy Treaties”, *The University Pennsylvania Law Review*, vol. 93, núm. 1, 1944. *Cfr.* traducción al castellano por H. PEREÑA DE MALAGÓN, *Biblioteca Jurídica Virtual*, Universidad Autónoma de México, Tomo 10, núm. 37, 1948, pp. 105-149.

internacional de 1894 realizado en el seno de la II Conferencia de La Haya de Derecho internacional privado<sup>5</sup>.

6. El proyecto vuelve a estar incluido en las agendas de la III y IV Conferencias de La Haya de 1900<sup>6</sup> y 1904<sup>7</sup>, retomándose de nuevo en los debates de la V Conferencia de La Haya de 1925, en la cual se elabora un proyecto de convención sobre la quiebra<sup>8</sup>. Este proyecto tiene influencia en los tratados bilaterales o multilaterales de ese periodo de entreguerras, como reflejan los textos del Tratado de Derecho internacional Privado de La Habana de 1928<sup>9</sup> y del Tratado Nórdico sobre quiebras de 7 de noviembre de 1933<sup>10</sup>.
7. En el marco del Consejo de Europa se adoptó el primer tratado multilateral en materia de insolvencia transfronteriza con el Convenio de Estambul de 5 de junio de 1990 sobre determinados aspectos de la quiebra internacional<sup>11</sup>.
8. Sin embargo, en las Comunidades Europeas ya habían estado trabajando durante años para elaborar un convenio internacional en materia de insolvencia<sup>12</sup>, habiéndose preparado los Anteproyectos de 1970<sup>13</sup>, de 1980<sup>14</sup> y de 1984<sup>15</sup>, que finalmente culminaron con la aprobación del Convenio de Bruselas de 23 de noviembre de 1995 relativo a los procedimientos de insolvencia<sup>16</sup>, acompañado del célebre Informe VIRGÓS / SCHMIT<sup>17</sup>. No obstante, este convenio comunitario nunca llegó a entrar en vigor.

<sup>5</sup> *Actes de la Deuxième Conférence de La Haye de Droit International Privé*, 1894, pp. 146-147.

<sup>6</sup> *Actes de la Troisième Conférence de Droit International Privé*, 1900, pp. 147-152.

<sup>7</sup> *Actes de la Quatrième Conférence de Droit International Privé*, 1904, pp. 222-223.

<sup>8</sup> *Actes de la Cinquième Conférence de Droit International Privé*, 1925, pp. 341-344. Cfr. M. O. HUDSON, "The progressive Codification of International Law", *American Journal of International Law*, Vol. 20, núm. 4, 1926, pp. 655-669; J. KOSTERS, "La Cinquième Conférence de Droit International Privé", *Revue de Droit International et de Législation Comparée*, 1926, pp. 245-280.

<sup>9</sup> Este Tratado, conocido como *Código Bustamante*, fue adoptado en el marco de la VI Conferencia Pan-Americana. Contiene normas de conflicto relativas a la quiebra.

<sup>10</sup> Firmado entre Dinamarca, Finlandia, Noruega y Suecia.

<sup>11</sup> Sólo fue firmado por Bélgica, Francia, Alemania, Grecia, Italia, Luxemburgo, Turquía y Chipre, éste último país el único en ratificarlo. El texto del Convenio de 1990 puede ser consultado en RCDIP, 1993, pp. 121 y ss. Sobre su análisis, P. VOLKEN, "L'harmonisation du droit international privé de la faillite", *RCADI*, 1991-V, t. 230, pp. 345-431; y M. OLIVENCIA RUIZ, "La evolución del Derecho de quiebra y el Consejo de Europa", *Liber amicorum. Colección de estudios jurídicos en homenaje al Profesor Pérez Montero*, Universidad de Oviedo, 1988, pp. 1047 y ss.

<sup>12</sup> Sobre esta evolución histórica, cfr. P. J. OMAR, "Genesis of the European Initiative in Insolvency Law", *International Insolvency Review*, 2003, Vol. 12, pp. 147-170.

<sup>13</sup> El Anteproyecto de 1970 se componía de ochenta y dos artículos, dos Anexos y un Protocolo. El texto se puede consultar en K. LIPSTEIN (ed.), *Harmonisation of Private International Law by the E.E.C.*, Institute of Advanced Legal Studies, Londres, 1978, pp. 169 y ss. Sobre una presentación general de su contenido, cf. J.A. PASTOR RIDRUEJO, "La faillite en droit international privé", *RCADI*, 1971-II, pp. 162 y ss.

<sup>14</sup> El Anteproyecto de 1980 se componía de ochenta y siete artículos, dos Anexos y un Protocolo, y fue publicado en el Boletín de las Comunidades Europeas, Suplemento 2/82. Sobre su contenido, cfr. I. F. FLETCHER, "Conflict of laws and European Community Law with special reference to the Community Conventions on Private International Law. The Draft Convention on Bankruptcy and related matters", R. H. GRAVESON (ed.), *Problems in Private International Law*, North Holland, Amsterdam, Nueva York, Oxford, 1982, pp. 187-249.

<sup>15</sup> Este Anteproyecto de 1984 fue resultado de una revisión del anterior por un Grupo de trabajo *ad hoc* denominado *Convention Faillite*, reunido entre abril de 1982 y 29 de junio de 1984. Se introdujeron modificaciones en determinados artículos y se eliminó de forma definitiva la Ley Uniforme. El texto se publicó de forma restringida en Documento del Consejo de las Comunidades Europeas núm. 8759/84 DRS (CFC), y puede consultarse en J. THIEME, *Vorschläge und Gutachten zum Entwurf eines EG-Konkursübereinkommens*, Tubinga, J. C. B. Mohr, 1988, pp. 417 y ss.

<sup>16</sup> Sobre su contenido, cf. M. VIRGÓS SORIANO, "The 1995 European Community Convention on Insolvency Proceedings: an Insider's View", *Forum internationale*, núm. 25, Kluwer, La Haya, 1998.

<sup>17</sup> El texto del Convenio y del Informe pueden consultarse en M. VIRGÓS SORIANO y F. J. GARCIMARTÍN ALFÉREZ, *Derecho procesal civil europeo*, McGraw-Hill, Madrid, 1996, pp. 421 y ss., y también en *Revista Española de Derecho Internacional*, 1995, pp. 5050 y ss.

9. La *comunitarización* del Derecho internacional privado tras la entrada en vigor del Tratado de Ámsterdam posibilitó la elaboración del Reglamento (CE) n° 1346/2000, de 29 de mayo de 2000, sobre procedimientos de insolvencia (en adelante REI), el cual establece normas comunes para los procedimientos transfronterizos de insolvencia en los países de la Unión Europea<sup>18</sup>.
10. El REI ha supuesto la *unificación* de las *normas de Derecho internacional privado* aplicables a los procedimientos de insolvencia transfronteriza abiertos en los Estados miembros, al establecer (i) criterios comunes para la determinación de los tribunales competentes para la apertura de un procedimiento de insolvencia; (ii) reglas para la determinación del ordenamiento aplicable al fondo del asunto; (iii) mecanismos de reconocimiento y ejecución de resoluciones judiciales en materia de insolvencia; y (iv) reglas de cooperación y coordinación procesal entre procedimientos paralelos de insolvencia<sup>19</sup>.
11. No podemos inferir que el REI instaure un *Derecho concursal comunitario uniforme*<sup>20</sup>, pero debido a su efecto unificador, el instrumento comunitario incorpora algunas reglas de *derecho sustantivo uniforme* al establecer *normas materiales especiales*, tales como la presentación de los créditos por parte de acreedores de otros países (artículos 39 a 42 REI), sobre igualdad del trato en el pago a los acreedores (artículo 20 REI) o reglas para la coordinación de los representantes de la insolvencia en caso de procedimientos paralelos (artículo 31 REI)<sup>21</sup>.
12. El REI ha sido modificado recientemente por el Reglamento (UE) n° 2015/848, de 20 de mayo<sup>22</sup>, que introduce modificaciones significativas en los procedimientos de insolvencia en Unión Europea, entre las que destacan la ampliación del ámbito de aplicación material, la introducción de reglas adicionales en la determinación de la competencia judicial internacional, se reforman los procedimientos secundarios y se incluye por vez primera el tratamiento de la insolvencia de sociedades pertenecientes a grupos multinacionales<sup>23</sup>.
13. Esta tendencia hacia la unificación de las normas de Derecho internacional privado se observa también en otros ámbitos regionales como el *Acte uniforme portant organisation des procédures collectives d'apurement du passif* aprobada en el marco de la OHADA, inspirada en el REI<sup>24</sup>.
14. Teniendo en cuenta los antecedentes de estos instrumentos, en gran medida elaborados en el marco de organizaciones internacionales de ámbito regional, cabe preguntarse el papel que ha desarrollado UNCITRAL en la codificación de la insolvencia transfronteriza.

B) *La labor de UNCITRAL en el proceso de codificación del Derecho de la insolvencia transfronteriza en el ámbito universal.*

15. La Resolución 2102 (XX), de 20 de diciembre de 1965, de la Asamblea General de la ONU, que ordenó la creación de UNCITRAL<sup>25</sup>, señalaba en su Preámbulo que “*los conflictos y divergencias que surgen de las leyes de los diversos Estados en materias relacionadas con el comercio internacional constituyen un obstáculo al desarrollo del comercio mundial*”. Por ello, la Resolución 2205 (XXI), de 17 de diciembre de 1966, de la Asamblea General de la ONU señaló que

<sup>18</sup> DOCE L 160 de 30.06.2000, pp. 1-18. Se aplica a los Estados miembros, a excepción de Dinamarca.

<sup>19</sup> F. CORDÓN MORENO, “La unificación del Derecho concursal en el ámbito de la Unión Europea: El Reglamento comunitario 1346/2000, de procedimientos de insolvencia”, *Unión Europea Aranzadi*, Vol. 30, núm. 3, 2003, pp. 5-14.

<sup>20</sup> Así lo indica el propio Considerando n° 11 del Preámbulo del REI, al expresar que “*el presente Reglamento acepta el hecho de que, para una amplia serie muy diferenciada de casos de derecho material, no resulta práctico un procedimiento único de insolvencia con validez universal para toda la Comunidad*”.

<sup>21</sup> J.-L. VALLENS, *L'insolvabilité des entreprises en droit comparé*, Joly, París, 2011, p. 118.

<sup>22</sup> DO L 141 de 05.06.2015, pp. 19-72. Se aplicará a partir del 26 de junio de 2017.

<sup>23</sup> P.A. DE MIGUEL ASENSIO, “La evolución del régimen europeo sobre procedimientos de insolvencia”, *La Ley Unión Europea*, núm. 8592.

<sup>24</sup> J.-L. VALLENS, *L'insolvabilité des entreprises en droit comparé*, Joly, París, 2011, p. 138.

<sup>25</sup> *Anuario de la Comisión de las Naciones Unidas para el Derecho Mercantil Internacional*, 1970, vol. 1, p. 19.



UNCITRAL nació con el objetivo de “*promover la armonización y unificación progresivas del Derecho mercantil internacional*”<sup>26</sup>.

16. Entre las técnicas a utilizar para alcanzar esos fines, el Informe del Secretario General encargado por la citada Resolución 2102 (XX) expresaba que se podrían seguir dos técnicas complementarias: (i) la elaboración de normas de Derecho internacional privado (*normas de conflicto*), y (ii) la unificación y armonización progresivas de las leyes sustantivas (*ley uniforme*)<sup>27</sup>.
17. No obstante la posibilidad de ambos instrumentos, hasta el momento UNCITRAL ha optado por la segunda de las opciones y, dentro de ella, por una preferencia del mecanismo de la *armonización* progresiva en detrimento de la *unificación*. Se ha descartado, por el momento, el uso de la técnica de las *normas de Derecho internacional privado*<sup>28</sup>.
18. Con base en el objetivo de la *armonización*, UNCITRAL aprobó el 30 de mayo de 1997 la *Ley Modelo sobre insolvencia transfronteriza* y su Guía de incorporación<sup>29</sup>, objeto ésta última de una reciente actualización<sup>30</sup>. La Ley Modelo supuso el primer texto de ámbito universal que pretendía armonizar las legislaciones nacionales en materia de insolvencia en el tráfico externo<sup>31</sup>.
19. Esta tendencia a la *armonización* frente a la *unificación* se vio confirmada con la elaboración de la *Guía Legislativa sobre el régimen de la insolvencia*, aprobada por UNCITRAL el 25 de junio de 2004<sup>32</sup>. Este texto de *soft law* tiene como finalidad informar y contribuir a la labor de reforma de los regímenes de la insolvencia sirviendo de texto referencia para las autoridades nacionales.
20. Con posterioridad, UNCITRAL ha aprobado la *Guía de prácticas sobre cooperación, comunicación y coordinación en procedimientos de insolvencia transfronteriza*, con el objetivo de proponer

<sup>26</sup> *Documentos Oficiales de la Asamblea General*, vigésimo primer periodo de sesiones, Anexos, tema 88 del programa, documentos A/6396 y Add. 1 y 2; Anuario de la Comisión de las Naciones Unidas para el Derecho Mercantil Internacional, 1970, vol. 1, pp. 68-70.

<sup>27</sup> Informe del Secretario General (“Estudio del Profesor Schmitthoff”), incluido en el documento A/6396. *Anuario de la Comisión de las Naciones Unidas para el Derecho Mercantil Internacional*, 1970, vol. 1, pp. 19-47, en especial pp. 22-23.

<sup>28</sup> Resulta paradigmática la intervención del representante de China en los trabajos preparatorios de la creación de la UNCITRAL: “*si los países lograsen establecer reglas uniformes de derecho sustantivo, desaparecería el interés de las reglas de derecho internacional privado (...) El proceso de codificación del derecho internacional privado y el de unificación del derecho privado están ambos destinados a favorecer el comercio internacional, siempre que estos dos procesos se desenvuelvan gradualmente y no persigan objetivos incompatibles*”. Documentos Oficiales de la Asamblea General, vigésimo periodo de sesiones, Sexta Comisión, 895ª sesión, párrafos 13 y 15.

<sup>29</sup> Sobre el contenido de la Ley Modelo, cfr. ESPLUGUES MOTA, C., “*The UNCITRAL Model Law of 1997 Cross Border Insolvency: an Approach*”, DCI, 1998, pp. 657 y ss.; FERNÁNDEZ DE LA GÁNDARA, L., “La Ley Modelo de UNCITRAL: una guía legislativa sobre el régimen de la insolvencia”, Comentarios a la Ley Concursal, FERNÁNDEZ DE LA GÁNDARA, L., y SÁNCHEZ ÁLVAREZ, M. Mª (Coord.), Marcial Pons, Madrid, 2004, pp. 815 y ss.

<sup>30</sup> Texto aprobado por UNCITRAL en su 973ª sesión celebrada el 18 de julio de 2013. También se ha completado con el documento denominado “*Ley Modelo sobre insolvencia transfronteriza: la perspectiva judicial*”, aprobado el 1 de julio de 2011 para ayudar a los jueces en cuestiones que puedan surgir en el contexto de una solicitud de reconocimiento presentada con arreglo a la Ley Modelo sobre la Insolvencia Transfronteriza. Este texto ha sido actualizado de nuevo en 2013.

<sup>31</sup> En su Preámbulo, la Ley Modelo señala que su finalidad es “*establecer mecanismos eficaces para la resolución de los casos de insolvencia transfronteriza con miras a promover el logro de (...) a) la cooperación entre los tribunales y demás autoridades competentes de este Estado y de los Estados extranjeros que hayan de intervenir en casos de insolvencia transfronteriza*”.

<sup>32</sup> Sobre el contenido de la Guía Legislativa, cfr. D. MORÁN BOVIO (Coord.), *Guía Legislativa de UNCITRAL sobre el Régimen de la Insolvencia*, La Ley, Monografía 5/2006, Madrid, 2006. La Guía Legislativa sobre el régimen de la insolvencia, que tenía en su origen solo dos Partes, ha sido completada posteriormente añadiendo la Parte Tercera (*Trato otorgable a los grupos de empresas en situaciones de insolvencia*), aprobada el 18 de julio de 2010, y la Parte Cuarta (*Obligaciones de los directores en el período cercano a la insolvencia*) aprobada el 18 de julio de 2013.

soluciones a los conflictos de jurisdicción y de autoridades que surgen en el tráfico externo en esta materia<sup>33</sup>.

21. En la actualidad, UNCITRAL trabaja en un *Proyecto de ley modelo sobre el reconocimiento y la ejecución de sentencias relacionadas con casos de insolvencia*<sup>34</sup>, una vez más en uso de la técnica del *soft law*.
22. Este importante desarrollo legislativo por parte de UNCITRAL elaborado a través de la técnica del *soft law* no pretende promover la unificación del Derecho sustantivo en materia de insolvencia, sino servir de inspiración al legislador nacional a la hora de regular esta institución en Derecho interno. El efecto de las leyes modelos es el de una armonización o unificación indirecta, puesto que las disposiciones modelos no serán incluidas en Derecho interno en el caso de que el legislador nacional adopte el texto propuesto como modelo, a diferencia del efecto directo de las leyes uniformes<sup>35</sup>.
23. Cabe plantearse si el uso por UNCITRAL de instrumentos no vinculantes de *soft law* como la Ley Modelo y la Guía Legislativa ha podido tener como consecuencia un menor grado de armonización y unificación en el Derecho de la insolvencia transfronteriza. Lo cierto es que solo una parte minoritaria de países ha adoptado el contenido de la Ley Modelo en su legislación, reduciendo aún más el efecto de armonización o de unificación indirecta perseguido. Por todo ello, resulta legítimo preguntarse si un instrumento internacional de unificación conflictual sería posible en el ámbito universal, en lo que se refiere a las reglas de Derecho internacional privado que resuelven el *conflicto de leyes y de jurisdicción* que se plantea.

## II. *La unificación conflictual en el ámbito universal del Derecho de la insolvencia transfronteriza a través de un convenio internacional.*

24. Analizaremos en primer lugar cuáles han sido los antecedentes de la presente propuesta de unificación conflictual de la insolvencia transfronteriza a través de un convenio internacional (*cfr. epígrafe A infra*) y cuál podría ser su contenido material (*cfr. epígrafe B infra*).

### A) *Antecedentes de la propuesta.*

25. Para la consecución de los objetivos perseguidos por la Resolución 2205 (XXI), de 17 de diciembre de 1966, de la Asamblea General de la ONU (“*promover la armonización y unificación progresivas del Derecho mercantil internacional*”), y coincidiendo con el quincuagésimo aniversario de la creación de UNCITRAL, quizás sea llevado el momento para acometer un instrumento vinculante de ámbito universal en materia de insolvencia transfronteriza que supere los obstáculos planteados por la diversidad de ordenamientos jurídicos nacionales y las limitaciones del uso de la técnica del *soft law*.
26. Se trata de retomar la idea del convenio internacional abordada ya en el curso de los debates que precedieron a la aprobación de la Ley Modelo de 1997, en los cuales se planteó la posibilidad de

<sup>33</sup> Aprobada por UNCITRAL el 1 de julio de 2009.

<sup>34</sup> UNCITRAL, A/CN.9/WG.V/WP.130, debatido en la 47ª sesión celebrada en Nueva York del 26 al 29 de mayo de 2015; A/CN.9/WP.5/WP.135, debatido en la 48ª sesión celebrada en Viena del 14 al 18 de diciembre de 2015; A/CN.9/WP.5/WP.138, debatido en la 49ª sesión celebrada en Nueva York del 2 al 6 de mayo de 2016; y A/CN.9/WG.V/WP.143, debatido en la 50ª sesión celebrada en Viena del 12 al 16 de diciembre de 2016.

<sup>35</sup> M. OLIVENCIA, “Ley y disposiciones legales modelo como instrumentos de armonización y unificación internacional del derecho de la insolvencia”, *Estudios de derecho mercantil: homenaje al profesor Justino F. Duque*, Vol. 2, 1998, pp. 1655-1663. Como ha afirmado el Profesor OLIVENCIA, “*como técnica de unificación, el efecto de las leyes modelo es indirecto, en cuanto que sus disposiciones no se integran en los Derechos nacionales, a diferencia de lo que sucede con las leyes uniformes. (...) Sólo si los legisladores adoptan como modelo el texto propuesto, tendrá éste un efecto indirecto de unificación*”; *op. cit.*, pp. 1655-1656.

elaborar, no disposiciones modelo, sino una convención internacional<sup>36</sup>, idea que finalmente fue descartada<sup>37</sup>.

27. De *lege ferenda*, este autor considera que el convenio internacional supone la técnica legislativa más adecuada para la evolución del Derecho de la insolvencia transfronteriza, en particular en lo relativo al reconocimiento y ejecución de sentencias<sup>38</sup>.
28. En esta línea de pensamiento, recientemente podemos destacar algunos avances significativos. En el debate sobre el futuro trabajo a realizar por el Grupo V de UNCITRAL, se presentaron diversas propuestas en relación con la elaboración de una convención internacional en materia de insolvencia transfronteriza<sup>39</sup>. Tras deliberar sobre estas propuestas, la Comisión de UNCITRAL decidió que el trabajo futuro del Grupo de Trabajo V consistiera en que “*se diera orientación a los Estados sobre la interpretación y aplicación de determinados conceptos de la Ley Modelo de la CNUDMI sobre la Insolvencia Transfronteriza relacionados con el centro de los principales intereses y, posiblemente, de que se elaborara una ley modelo o disposiciones modelo sobre el régimen de la insolvencia en que se regularan determinadas cuestiones de derecho internacional de la insolvencia, como la jurisdicción, el acceso a los tribunales extranjeros y el reconocimiento de los procedimientos extranjeros, de un modo que no impidiera preparar una convención*”<sup>40</sup>.
29. Fruto de los posteriores debates del Grupo V en el estudio de las disposiciones modelo sobre el centro de intereses principales del deudor, se creó un grupo *ad hoc* de expertos para el estudio de la viabilidad de una convención internacional sobre insolvencia transfronteriza<sup>41</sup>. Sin embargo, por el

<sup>36</sup> UNCITRAL, A/CN.9/433, debatido en el 30º período de sesiones del Grupo de Trabajo V celebrado en Viena del 7 al 28 de octubre de 1996. Se reproduce el párrafo 17: “*No obstante, se presentaron argumentos en pro de un proyecto de convención. Se consideró que para regular las cuestiones tratadas, que se referían esencialmente a la cooperación judicial internacional, sería más apropiado que el texto revistiera la forma de una convención, en vez de disposiciones legales modelo. Se sostuvo que esas cuestiones requerían un mayor grado de uniformidad, que era imposible de lograr con una ley modelo, dado que los Estados, al aplicar una ley modelo, eran libres de introducir cambios sustanciales en su texto. También se señaló que en algunos Estados la cooperación con autoridades judiciales extranjeras estaba tradicionalmente sujeta a la regla de la reciprocidad. Se afirmó asimismo que, mientras que en el caso de las convenciones internacionales era fácil demostrar que se había cumplido con la regla de la reciprocidad, con una ley modelo resultaría mucho más difícil de comprobar. Además, se sostuvo que en un tema como el de la insolvencia transfronteriza, aunque resultara más difícil elaborar una convención que una ley modelo, lo cierto es que la convención sería más fácil de aplicar.*”

<sup>37</sup> UNCITRAL, A/CN.9/433, cit. en nota 36, párrafo 20: “*el Grupo de Trabajo decidió proseguir y llevar a término su labor sobre el proyecto de Disposiciones Legales Modelo, sin perjuicio de la posibilidad de que se formularan unas disposiciones convencionales modelo o una convención propiamente dicha sobre cooperación judicial en materia de insolvencia transfronteriza, si posteriormente la Comisión así lo decidiera.*”

<sup>38</sup> En el mismo sentido, cfr. G. BAER, “Towards an International Insolvency Convention: Issues, Options and Feasibility Considerations”, *Business Law International*, vol. 17, núm. 1, 2016, pp. 5-25. En palabras de M. OLIVENCIA RUIZ, op. cit., p. 1663: “*el tratado internacional es la forma más idónea, y por ello prioritaria, para regular los temas de reconocimiento y de cooperación, una fuente ante la que ceden las disposiciones legales concebidas como modelo (...)*”.

<sup>39</sup> UNCITRAL, A/CN.9/433, cit. en nota 31, párrafo 20; sobre el origen de esta propuesta cfr. A/CN.9/WG.V/XXXVII/CRP.3, presentado por el autor de este estudio en nombre de la Unión Internacional de Abogados (UIA) relativa a la elaboración de un tratado internacional sobre insolvencia transfronteriza. En el mismo sentido la propuesta de la International Bar Association (IBA) [Documento A/CN.9/WG.V/WP.93/Add.6]. Dichas propuestas fueron debatidas por el Grupo de Trabajo V en su 37º período de sesiones (Viena, 9 a 13 de noviembre de 2009) (A/CN.9/686, párrs. 127 a 130) y en el 38º período de sesiones (Nueva York, 19 a 23 de abril de 2010) (A/CN.9/691, párrs. 99 a 104). Sobre los antecedentes y génesis de estas propuestas, cfr. D. MORÁN BOVIO, “UNCITRAL on Insolvency Law: Third Act, First Scene”, *World Arbitration & Mediation Review*, vol. 6, nº 1, pp. 139-159.

<sup>40</sup> UNCITRAL, A/CN.9/691, párrafo 104, en relación con la propuesta de los Estados Unidos descrita en A/CN.9/WG.V/WP.93/Add.1, párrafo 8.

<sup>41</sup> UNCITRAL, A/CN.9/798, párrafo 44, deliberado en el 44º período de sesiones celebrado en Viena del 16 al 20 de diciembre de 2013. Este grupo *ad hoc* se reunió por primera vez para abordar esta propuesta con ocasión de la 45ª sesión del Grupo de Trabajo V celebrada en Nueva York del 21 al 25 de abril de 2014. La última reunión ha sido celebrada durante la 49ª sesión del Grupo V celebrada en Nueva York del 2 al 6 de mayo de 2016.

momento, el tema de la convención no ha sido considerado como una prioridad en la agenda de trabajo del grupo V<sup>42</sup>.

30. La tarea de estudiar la viabilidad de elaborar un convenio internacional en materia de insolvencia transfronteriza ha cobrado si cabe más relevancia puesto que en la actualidad la Conferencia de la Haya de Derecho internacional privado se encuentra en proceso de elaboración de un *proyecto de convención sobre el reconocimiento y la ejecución de sentencias en materia civil y comercial*<sup>43</sup>. En el estado actual del borrador, la insolvencia se encuentra excluida de su ámbito material de aplicación<sup>44</sup>. En nuestra opinión, la exclusión de esta materia de la futura convención internacional sobre reconocimiento y ejecución de sentencias extranjeras de La Haya evidenciaría aún más la ausencia de un instrumento vinculante de ámbito universal sobre los efectos extraterritoriales de los procedimientos de insolvencia transfronteriza.
31. En el estado actual de la cuestión, la propuesta que se formula en el presente estudio es la viabilidad de un convenio internacional como cauce de unificación de las normas de Derecho internacional privado en el ámbito universal.

B) *Propuesta lege ferenda: un convenio internacional para la unificación conflictual en materia de insolvencia transfronteriza.*

32. En el Informe del Secretario General encargado por la citada Resolución 2102 (XX) expresaba que se podrían seguir dos técnicas complementarias: (i) la elaboración de normas de Derecho internacional privado (*normas de conflicto*), y (ii) la unificación y armonización progresivas de las leyes sustantivas (*ley uniforme*)<sup>45</sup>. Pues bien, el convenio internacional objeto de la propuesta se encuadraría en la técnica de Derecho internacional privado con el objetivo de unificar las normas de conflicto y de jurisdicción aplicables en los procedimientos de insolvencia transfronteriza.
33. Consideramos que el convenio internacional supone la técnica legislativa más adecuada para reforzar los objetivos de cooperación, coordinación y asistencia judicial internacional en los procedimientos de insolvencia transfronterizos, puesto que es un instrumento vinculante para los Estados partes que garantiza la reciprocidad, superando la ausencia de carácter vinculante del *soft law*. Contribuiría a la atribución de efectos extraterritoriales a las resoluciones judiciales extranjeras, mejorando los principios de reconocimiento y ejecución de las mismas.
34. En cuanto al contenido del instrumento, este autor ha propuesto ya con anterioridad en UNCITRAL que un convenio internacional sobre insolvencia transfronteriza pudiera contener disposiciones sobre (i) el acceso de los tribunales a los representantes extranjeros de la insolvencia; (ii) el reconocimiento de los procedimientos extranjeros de la insolvencia; (iii) la comunicación, coordinación y cooperación entre los representantes de la insolvencia y los tribunales; (iv) la competencia judicial internacional para la apertura de los procedimientos de insolvencia; y (v) reglas sobre ley aplicable<sup>46</sup>.

<sup>42</sup> UNCITRAL, A/71/17, párrafo 247, *Informe de UNCITRAL*, deliberado en la 49ª sesión celebrada del 25 de junio al 15 de julio 2016. Se reproduce el párrafo 247: “la Comisión señaló que un grupo especial de composición abierta, integrado por interesados, podría seguir estudiando oficiosamente la viabilidad de elaborar una convención sobre cuestiones de insolvencia de carácter internacional teniendo en cuenta una lista de cuestiones preparada y distribuida por la Secretaría. Sin embargo, observando que el Grupo de Trabajo V ya tenía un programa de actividades muy nutrido y que la Secretaría quizás tuviera poco tiempo y recursos para realizar esa labor oficiosa, la Comisión acordó que esa labor solo se llevara a cabo en la forma y en el momento en que la Secretaría pudiera hacerlo.”

<sup>43</sup> Cfr. *Preliminary Draft convention* aprobado por la Comisión Especial celebrada del 16 al 24 de febrero de 2017. Publicado online [<https://assets.hcch.net/docs/48e64d28-fc33-4927-b323-4e2fa6a10ab2.pdf>]

<sup>44</sup> El artículo 2.2, letra e), del proyecto de convención está actualmente redactado como sigue: “*This Convention shall not apply to the following matters: (...) e) insolvency, composition, resolution of financial institutions, and analogous matters.*”

<sup>45</sup> Cfr. Nota 27 supra, Informe del Secretario General (“Estudio del Profesor Schmitthoff”).

<sup>46</sup> Á.Mª BALLESTEROS BARROS, “*Propuesta de convenio internacional sobre insolvencia transfronteriza*”,

35. En aras de favorecer la existencia de un consenso mayoritario, las materias enumeradas como (i), (ii) y (iii) podrían ser consideradas como prioritarias; las materias enumeradas como (iv) y (v) podrían ser objeto de negociaciones paralelas susceptibles de encuadrarse en Protocolos separados.
36. Estas materias fueron consideradas como susceptibles de ser incorporadas a un posible convenio internacional por parte de la Secretaría de UNCITRAL<sup>47</sup>. Otros autores han sugerido ampliar el contenido de la propuesta a materias como el establecimiento de un tribunal internacional para la resolución de disputas en materia de insolvencia<sup>48</sup> o los planes de reestructuración y acuerdos de refinanciación<sup>49</sup>.
37. A la hora de redactar el convenio, el contenido de la Ley Modelo, de la Guía Legislativa y los demás textos elaborados por UNCITRAL en esta materia servirían de inspiración, puesto que constituyen un paradigma de normativa sobre insolvencia transfronteriza. En concreto, el *Proyecto de ley modelo sobre el reconocimiento y la ejecución de sentencias relacionadas con casos de insolvencia*, en curso de elaboración en la actualidad, supone un importante texto de referencia, por cuanto aborda el tratamiento de la extraterritorialidad de las resoluciones judiciales en materia de insolvencia, lo cual es uno de los principios clásicos del Derecho internacional privado.

### *Reflexión final*

38. La elaboración de un instrumento vinculante como el convenio internacional propuesto supone un reto que contribuiría sin duda alguna a la modernización y unificación de las normas que rigen el Derecho de la insolvencia transfronteriza, justificando con ello los objetivos perseguidos desde la creación de UNCITRAL y contribuyendo al éxito de la importante labor que esta organización internacional ha demostrado durante los cincuenta años de existencia que ahora felizmente conmemoramos.

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*Fourth International Insolvency Law Colloquium*, UNCITRAL, celebrada en Viena del 16 al 18 de diciembre de 2013.

<sup>47</sup> UNCITRAL, documento difundido por la Secretaría de manera informal a los Delegados y Observadores internacionales con motivo de la reunión del grupo ad hoc durante la 49ª sesión celebrada en Nueva York del 2 al 6 de mayo de 2016. Estas materias relacionadas en la propuesta son las siguientes (original en inglés): (a) Granting foreign insolvency representatives access to courts; (b) Recognition of foreign insolvency proceedings (with the effect of granting the foreign proceeding the rights of a national proceeding or triggering a secondary proceeding); (c) Cooperation and communication between insolvency representatives and courts; (d) Direct competence (for commencement of proceedings, whether main or non-main); e) Applicable law; (f) Multinational enterprise groups; and (g) Recognition and enforcement of insolvency-related judgments.

<sup>48</sup> G. BAER, *op. cit.*, pp. 13-15.

<sup>49</sup> B. WESSELS, *Judicial Coordination of Cross-border Insolvency Cases*, Kluwer, Deventer, 2008, p. 45: “Such a convention should act as an aid for judges to navigate in uncharted waters, should ensure that all stakeholders in a restructuring or insolvency have the information they need to make informed decisions and should adopt procedural safeguards to ensure the integrity of all judgments given.” Postura mantenida en su entrada en el *Leiden Law Blog* de fecha 24 de mayo de 2016 (<http://leidenlawblog.nl/articles/towards-a-worldwide-international-insolvency-convention>).

## *The Certainty of Choice of Law Rules in the Uncertain World of International Bank Insolvency*

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“You cannot solve a problem from the same consciousness that created it.  
You must learn to see the world anew.” — Albert Einstein

The current initiative by the UNCITRAL Working Group V (Insolvency) in respect of an international convention in international insolvency presents the significant opportunity to address the harmonization of choice of law rules in cross-border bank insolvency cases. The current study of an international convention in international insolvency law presents the chance to conceptualize an approach that can greatly assist other global leaders by addressing the choice of law issues in the cross-border insolvency of large, complex financial institutions. In a post-Brexit climate, the cross-border insolvency of large, complex financial institutions creates new complex choice of law and jurisdictional issues including the law applicable in insolvency proceedings. As the international insolvency law in the European Union (EU) progresses in the harmonization of its laws,<sup>1</sup> the dichotomy has emerged with the exit of the United Kingdom (UK) in respect of choice of law issues in international bank insolvency. When national interests override international objectives, the conflicts consistently remain problematic, with little potential for the creation of solutions. These conflicts have exposed the need for harmonized choice of law rules to resolve the multi-jurisdictional complexities in international bank insolvency. Whenever another State intervenes between the relationship of territory and jurisdiction, the result will be a loss of legal certainty.<sup>2</sup> The exit of the UK from the EU deepens the complexity of perplex jurisdictional questions. Although these issues have been discussed in past cross-border insolvency cases, the implications of Brexit will affect the terms of recognition of judgements in complex cross-border bank insolvency matters. For example, as the European Insolvency Regulation is no longer applicable to the UK post-Brexit, banks that open insolvency proceedings in the UK risk competing insolvency proceedings being commenced in other jurisdictions with no reliance on the primacy of the UK proceedings.<sup>3</sup> The multiple openings of competing insolvency proceedings post-Brexit premised on the need to seize its assets in each of the jurisdictions where these are located creates new complex choice of law issues. This proposal will focus on the critical analysis of the uncertainty of the international insolvency architecture post-Brexit in respect of international bank insolvency and the significant contribution that UNCITRAL can make towards the certainty of substantive choice of law rules in international bank insolvency.

### *The Objectives of the Research Proposal*

The objective of this research proposal is to contribute towards the innovation of international insolvency in respect of achieving solutions to choice of law issues in international bank insolvency. The greater precision and uniformity of solutions would reduce the uncertainty caused by variations between the choice of law rules deployed by different legal systems.<sup>4</sup> As full convergence of insolvency laws is currently not realistic, improving problems related to choice of law in the context of cross-border insolvency is an outstanding task.<sup>5</sup> Conflicts between common law and civil law systems and within their competing legal systems also indicate that there is a need to harmonize choice of law rules between national insolvency regimes. The differences in substantive law between national regimes occur because of the economic structure of the market, the underlying policies of the legal systems, the order of private law, and the

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<sup>1</sup> European Commission Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU (2016/0359 (COD)), 17.

<sup>2</sup> Matthias Herdegen, *Principles of International Economic Law*, (Oxford University Press, London), 2013, 91.

<sup>3</sup> Hogan Lovells, *The Brexit Effect: the Legal Implications Behind the Headlines* (2016), 10 <<https://www.hoganlovells.com/en/publications/brexit-effect-note-the-legal-implications-behind-the-headlines>>.

<sup>4</sup> Ian F. Fletcher, *Insolvency in Private International Law: National and International Approaches* (Oxford University Press, 2<sup>nd</sup> ed, 2005), 508.

<sup>5</sup> *Ibid.*, 508.

protected interests in the system of insolvency law.<sup>6</sup> These conflicts have exposed the need for standard international rules<sup>7</sup> to govern choice of law issues in international bank insolvency. The debates over traditional legal doctrine and new policy present a significant opportunity to reconsider solutions to choice of law issues in international bank insolvency underlying the EU and the UK post-Brexit.

The proposal acknowledges the importance of the UNCITRAL Model Law on Cross-Border Insolvency as a source of reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the existing adequacy of existing laws and regulations.<sup>8</sup> The proposal further acknowledges that reconciling international insolvency regimes between common and civil law systems is a key objective of insolvency law. Although the UNCITRAL Model Law has not led to harmonization across common and civil law systems, the proposal aims to make a significant contribution towards the harmonization across common and civil legal systems, the further harmonization of choice of law rules,<sup>9</sup> as well as to the innovation of substantive choice of law rules in international bank insolvency. The proposal addresses the opportunity that is presented to UNCITRAL to formulate substantive choice of law rules in international bank insolvency within its study of an international convention. Ultimately, the contribution of UNCITRAL in seizing this opportunity would result in greater legal certainty in international insolvency law and procedures towards uniformity with international implications.

### *The Current State of Affairs*

In March 2017, the official exit of the UK from the EU is intended to be marked by the instigation of *Article 50* of the Lisbon Treaty.<sup>10</sup> When the UK officially leaves the EU, this creates the potential lacuna in respect of choice of law issues concerning automatic recognition of cross-border insolvency proceedings, the law applicable and governing jurisdiction in complex international bank insolvency cases. In the absence of a common recognition framework, alternative agreements or treaties, the UK will return to its pre-2002 conflicts position without an international framework addressing the cross-border recognition post-Brexit.<sup>11</sup> The UK Government has confirmed that on the day of the exit of the UK, EU law will (in the absence of specific agreement) cease to apply.<sup>12</sup> As a consequence, EU law will no longer be given primacy,

<sup>6</sup> Bob Wessels, *International Insolvency Law* (Kluwer Law International, 2<sup>nd</sup> ed, 2006), 5.

<sup>7</sup> Michael H. Krimminger, 'The Resolution of Cross-border Banks: Issues for Deposit Insurers and Proposals for Co-operation', (2008) 4(4) *Journal of Financial Stability* 376, 379.

<sup>8</sup> United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law*, (25 June 2004).

<sup>9</sup> Charles. W Mooney, Jr., 'Harmonizing Choice of Law Rules for International Insolvency Cases: Virtual Territoriality, Virtual Universalism, and the Problem of Local Interests', 9(1) (2014) *Brooklyn Journal of Corporate, Financial & Commercial Law* 120.

<sup>10</sup> *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community of the Treaty on European Union*, signed on December 13, 2007, *Official Journal of the European Union* 2007/C 306/01, (entered into force on December 1, 2009), Article 50. See also United Kingdom Department for Exiting the European Union, 'The United Kingdom's Exit From and New Partnership with the European Union White Paper' (February 2017), 65 which states that, 'As set out in Article 50, the Treaties of the EU will cease to apply to the UK when the withdrawal agreement enters into force, or failing that, two years from the day we submit our notification, unless there is a unanimous agreement with the other 27 Member States to extend the process'; Vaughne Miller et al, 'Brexit: How Does the Article 50 Process Work?', (Briefing Paper No. 7551, House of Commons Library, Parliament of United Kingdom, 2016); Paul Bowers et al, 'Brexit: Some Legal and Constitutional Issues and Alternatives to EU Membership' (Briefing Paper No. 07214, House of Commons Library, Parliament of United Kingdom, 2016); United Kingdom Department for Exiting the European Union, 'A Statement from the Secretary of State for Department for Exiting the European Union on the process of invoking Article 50 (7 November 2016), Gov.UK, <<https://www.gov.uk/government/speeches/process-for-invoking-article-50-ministerial-statement-7-november>>.

<sup>11</sup> Hogan Lovells, above n3, 7; Jack S. Caird, 'Brexit: Legislating for the Great Repeal Bill', (Briefing Paper No. 7793, House of Commons Library, Parliament of United Kingdom, 2016), 52 where it states that: 'The UK Government has since stated that one of the aims of the Great Repeal Bill is to end the jurisdiction of the Court of Justice of the European Union (CJEU) over the UK. It will no longer be obligatory for post-Brexit courts in the UK to abide by the rulings of the CJEU. Once the European Communities Act (1972) is repealed, the courts in the United Kingdom will no longer be under the obligation to give effect to EU law over and above domestic law'.

<sup>12</sup> United Kingdom Department for Exiting the European Union, 'Government announces end of European

and legal provisions on the statute book which originated will be afforded the same status as other provisions of domestic law.<sup>13</sup> In the path forward, recognition by EU Member States of English insolvency proceedings will revert back to principles of comity or local law provisions; in particular, whether relevant Member States have implemented the UNCITRAL Model Law.<sup>14</sup> Although the philosophy of the European Commission has greatly emphasized and required a new approach to the recognition of judgments in English private international law,<sup>15</sup> the focus of private international law whereby jurisdiction and private international law rules dominate has been to the detriment of choice of law rules.<sup>16</sup> As most recent legislation in respect of private international law has been concerned with recognition, the Law Commission recommendations and Hague Conventions on choice of law issues have, generally, not been legislated in statute to the disadvantage of the governing law.<sup>17</sup> The emergence of the doctrine of *forum non conveniens* has also reduced the likelihood that cases will be heard in England which requires application of choice of law rules to determine the governing law.<sup>18</sup>

### *The Certainty of Choice of Law Issues in International Bank Insolvency post-Brexit*

In the past, a major characteristic of conflict of laws was that states developed individualistic solutions to resolve the diverse problems caused by various sovereign states.<sup>19</sup> In effect, this had the consequence of creating numerous systems of conflicts of laws and the ensuing choice of law issues<sup>20</sup> which exacerbates the legal uncertainty of international bank insolvency post-Brexit. In the present EU legal framework, the choice of law to govern the insolvency procedure is decided in part on the allocation of a jurisdiction, and also, on the private international law rules inherent in the legal systems of the Member States.<sup>21</sup> While these rules decide the primacy of rules where there is conflict and the extent to which other systems of rules will be recognized,<sup>22</sup> this choice of law system will no longer include the UK's jurisdictional paradigm post-Brexit. It is the law of the jurisdiction where proceedings are opened that will govern many of the substantive issues during proceedings. However, the regulatory framework of international insolvency law has not been analysed against traditional conflict of laws thinking.<sup>23</sup> In deferring to foreign courts and their proceedings, the recognition of foreign judgements and application of foreign law may not be workable if the domestic court does not recognize or permit the enforcement of the foreign judgement or law, if the application of foreign law creates conflicts, and if national interests override international concerns.<sup>24</sup> In the case of *Rubin v Eurofinance*,<sup>25</sup> the court stated that there was no expectation of reciprocity from other

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Communities Act' (2 October 2016), Gov.UK, <<https://www.gov.uk/government/news/government-announces-end-of-european-communities-act>>. The Great Repeal Bill will repeal the European Communities Act (1972) and 'convert existing law into domestic law, while allowing Parliament to amend, repeal, or improve any law after appropriate scrutiny and debate'.

<sup>13</sup> Caird, above n 11 whereby it states that, 'A related question concerns the approach of the UK's courts to interpreting domestic laws based on EU law after Brexit day. Currently domestic courts will often look behind a provision of domestic law to the relevant EU provision, for example a Directive, to assist their interpretation and application of the law. It is not known to what extent this will continue after Brexit.'

<sup>14</sup> Weil, Gotshal and Manges, 'Brexit: Implications for the Restructuring and Insolvency Market', (2016), 1, <<http://www.weil.com/~media/brexit/pdf/brexit-implications-for-the-restructuring-and-insolvency-mark.pdf>>.

<sup>15</sup> Rhona G. Schuz, 'Conflicts between Choice of Law Rules and Recognition of Judgement Rule with Particular Reference to Cases involving Determination of Status', (PhD Thesis, University of London, 2014), 58.

<sup>16</sup> Ibid., 55.

<sup>17</sup> Ibid., 59.

<sup>18</sup> Ibid.

<sup>19</sup> Bob Wessels, *Cross-Border Insolvency Law* (Kluwer Law International, 2007), 836.

<sup>20</sup> Michael J. Whincorp & Mary Keyes, *Policy and Pragmatism in the Conflict of Laws* (Dartmouth Publishing Ltd, 2001), 188. See also Brooklyn Law School Center for the Study of Business Law and Regulation, Brooklyn Journal of Corporate, Financial & Commercial Law Annual Symposium: Choice of Law in Cross-Border Bankruptcy Cases (March 7, 2014).

<sup>21</sup> Gabriel Moss QC, Ian Fletcher QC, and Stuart Isaacs QC, *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings*, (Oxford University Press, 3<sup>rd</sup> edn, 2016), 7274.

<sup>22</sup> Paul Omar, 'The European Insolvency Regulation 2000: A Paradigm of International Insolvency Cooperation', (2003) 15(1) *Bond Law Review* 214, 234.

<sup>23</sup> Hannah L. Buxbaum, 'Rethinking International Insolvency: the Neglected Role of Choice-of-Law Rules and Theory', 36 (2000) *Stanford Journal of International Law* 23, 25.

<sup>24</sup> Ralf Michaels, *Max Planck Encyclopedia of Public International Law*, (Oxford University Press, 2009), 1.

<sup>25</sup> *Rubin v Eurofinance SA* [2012] UKSC 46.



countries and no UK case or statutory law as such; being in the provenance of legislature.<sup>26</sup> While a common law system often claims for itself a universal role,<sup>27</sup> this is based on the preservation of the fundamental unity of its national laws by insisting that they be followed in other jurisdictions. The majority opinion of *Rubin* represents a deliberate decision to favour traditionalist common law over the policy objectives of modified universalism.<sup>28</sup> The persuasive precedent of the case illustrates that courts worldwide can maintain parochial authority while eschewing cooperative measures by foreign courts. The inadvertent consequence is that other courts facing conflict of laws issues in an insolvency context will view the case as a prominent guide to the interpretation of the Model Law.<sup>29</sup> In a post-Brexit climate, the distinct territorialist policies are at the forefront of cross-border insolvency jurisprudence.<sup>30</sup> Furthermore, when the UK is no longer bound by the Insolvency Regulation, conflicts with the UK will fall outside its scope of application. When the UK leaves the EU, so too will its adherence to the Insolvency Regulation and the laws applicable to the recognition of insolvency proceedings and foreign judgements. The consequences of the treatment of UK insolvency proceedings in the courts of the remaining Member States (and the treatment of EU insolvency proceedings in the UK courts) remain unclear.<sup>31</sup> The applicable insolvency law is to be determined according to the national rules of cross-border insolvency law;<sup>32</sup> the variations of which render the outcome uncertain. The international insolvency architecture to resolve conflicts that arise from choice of law issues creates no mechanism for balancing the international and domestic considerations nor arriving at a choice between them.<sup>33</sup>

On a national level, the choice-of-law codification in the EU has provided comprehensive and uniform systems of carefully drafted and workable rules. However, when the UK leaves the EU, the European choice-of-law codification must co-exist with competing choice-of-law regimes on multiple levels.<sup>34</sup> The new paradigm post-Brexit necessitates codifications from several levels to be applied in parallel which creates difficulties if they are not sufficiently coordinated in multi-jurisdictional international bank insolvency. The lack of synchronisation can instigate the confusion and uncertainty which the codification intended to mitigate at the first instance.<sup>35</sup> The necessity to address the fundamental juridical nature, classification and private law enforcement of jurisdiction and choice of law issues in the private international law regime of the EU and the UK is greater than ever. When international structural order is compromised in the unilateral private law enforcement of jurisdiction and choice of law agreements,<sup>36</sup> national sovereignty gives rise to conflicts between national regimes and sovereign legal orders.<sup>37</sup> The

<sup>26</sup> *Rubin v Eurofinance SA* [2012] UKSC 46, [126-129]. See also Tristan G. Axelrod, 'UK Supreme Court Highlights Parochial Roadblocks to Cooperative Cross-border Insolvency in *Rubin V. Eurofinance SA*', 31(4) (2014) *Cooperative Cross-border Insolvency* 818, 837.

<sup>27</sup> Patrick H Glenn, Patrick H, *Legal Traditions of the World* (2007), 165.

<sup>28</sup> *Rubin v Eurofinance SA* [2012] UKSC 46, [128-132].

<sup>29</sup> Axelrod, above n26, 852.

<sup>30</sup> *Ibid.*

<sup>31</sup> Vaughne Miller (ed.), 'Brexit: Impact Across Policy Areas', (Briefing Paper No. 07213, House of Commons Library, Parliament of United Kingdom, 2016); 44; Burkhard Hess, 'Back to the Past: Brexit and European International Private and Procedural Law', (November 14, 2016), Max-Planck-Gesellschaft <<https://www.mpg.de/10824865/back-to-the-past>> which states that: 'While the cross-border recognition and coordination of insolvency proceedings cannot be excluded, it will nevertheless be laden with significant legal uncertainty'.

<sup>32</sup> Thomas Bil and Glen Flannery, 'Brexit: Implications for Restructuring and Insolvency- a British and Dutch Perspective', (November 2016), 52, <<http://www.nabarro.com/media/644166/brexit-dutch-perspective.pdf>>.

<sup>33</sup> Buxbaum, above n23, 41. See, generally, Albert Venn Dicey, *Dicey, Morris and Collins on the Conflict of Laws* (Sweet & Maxell, 15<sup>th</sup> edn, 2016); David C. Jackson, 'The Conflicts Process: Jurisdiction and Choice on Private International Law', (Oceana Publications, 2005).

<sup>34</sup> Mathias Reimann, 'Choice of Law Codification in Modern Europe: the Costs of Multi-level Law-Making', (2015) 49 *Creighton Law Review* 507, 514.

<sup>35</sup> *Ibid.*

<sup>36</sup> Mukarrum Ahmed, 'A Comparative Study of the Fundamental Juridical Nature, Classification, and Private International Law Enforcement of Jurisdiction and Choice of Law Agreements in the English Common Law of Conflict of Laws, the European Private International Law Regime and the Hague Convention on Choice of Law Agreements', (PhD Thesis, University of Aberdeen, 2015), 12.

<sup>37</sup> *Ibid.*

possibility of ‘regime collision’ through interference with the jurisdiction, judgments<sup>38</sup> and choice of law apparatus of foreign courts creates the complex multilateral problems of international bank insolvency. The nature of international bank insolvency magnifies the cross-border conflicts when the regime collision between the domestic rules of the EU and the UK occur post-Brexit. This undermines the certainty of international bank insolvency post-Brexit and gives rise to significant choice of law issues.

At present, when a conflict arises between the laws of the UK and the EU, the Insolvency Regulation takes precedence<sup>39</sup> to decide the recognition of main and secondary insolvency proceedings. However, in a post-Brexit climate, the automatic recognition of main and secondary proceedings provided by the Regulation may not be possible when the administration orders by the English courts may no longer be recognized in the EU.<sup>40</sup> The automatic recognition and relief provided by the Credit Institutions Winding-Up Directive<sup>41</sup> would also cease to extend its recognition to the UK.<sup>42</sup> As EU directives prevail only if and to the extent that there is applicability, the Credit Institutions Winding-Up Directive will cease to extend recognition to the UK post-Brexit.<sup>43</sup> The single entity approach under the Directive would cease to exist in the absence of an agreement to the contrary.<sup>44</sup> When an international bank is incorporated within the EU with a legitimate argument as to its COMI, there is potentially the greater risk of conflict of jurisdiction and a denial of recognition of the UK court’s judgement.<sup>45</sup> In the Member States in which the regulations are applicable, they do not constitute a choice-of-law regime.<sup>46</sup> If the international bank is incorporated within the EU and with no COMI establishment in the UK, there is also the greater risk that those proceedings would not be recognized by that EU Member State.<sup>47</sup> Once the advantage of automatic recognition ceases to apply, the extent that the Model Law has been adopted by the Member State requires significant consideration. In this instance, the level of assistance under the Model Law becomes much more restrictive than the automatic recognition regime available under the Insolvency Regulation.<sup>48</sup> There would not only be no automatic recognition of EU Member State insolvency proceedings in the UK, but the UK courts could exercise judicial discretion to commence insolvency proceedings. The dichotomy of the UK and the EU post-Brexit means that the opening of main insolvency proceedings in respect to all foreign group companies of an international bank will be granted recognition in one jurisdiction. International banks with complex operational structures and various foreign group companies would face great uncertainty in the recognition of the opening of foreign main proceedings and the law applicable to govern those proceedings.

The contest for jurisdiction when dealing with the insolvencies of a group with non-European member companies becomes exacerbated<sup>49</sup> in international bank insolvency with jurisdictional claims that conflict

<sup>38</sup> Ibid.

<sup>39</sup> United Nations Commission on International Trade Law, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, (30 May 1997), Article 3.

<sup>40</sup> Clifford Chance, ‘Briefing Note: Brexit: Initial Considerations in the Restructuring and Insolvency Market’ (July 2016), 2. <[http://www.lma.eu.com/application/files/2514/6900/7940/Brexit\\_initial\\_considerations\\_in\\_restructuring\\_and\\_insolvency\\_market.pdf](http://www.lma.eu.com/application/files/2514/6900/7940/Brexit_initial_considerations_in_restructuring_and_insolvency_market.pdf)>.

<sup>41</sup> *European Parliament and Council Directive 2001/24/EC on the Reorganisation and Winding-up of Credit institutions* (entered into force on 5 May 2001).

<sup>42</sup> Sonya L. Van de Graaff, Peter J.M. Declercq and Howard Morris, ‘Brexit: Impact on Restructuring and Insolvency for Credit Institutions’ (July 7, 2016), <<http://www.lexology.com/library/detail.aspx?g=239ce14e-1049-473e-8dc6-6e00f5c0c4b2>>.

<sup>43</sup> Ibid.

<sup>44</sup> Ashurst, ‘Brexit: Potential Impact on the UK Banking Industry’ (1 March 2016), <<https://www.ashurst.com/en/news-and-insights/insights/brexit-potential-impact-on-the-uk-banking-industry/>>.

<sup>45</sup> Clifford Chance, above n40; and generally, Matthias Lehmann and Dirk Zetsche, ‘Brexit and the Consequences for Commercial and Financial Relations between the EU and the UK’ (2016) 27 *European Business Law Review* 999, 1020; Nicholas W.A. Tollenaar, ‘Dealing with the Insolvency of Multi-national Groups under the European Insolvency Regulation, (2010) 23(5) *Insolvency Intelligence* 65, 70.

<sup>46</sup> Reimann, above n34, 515.

<sup>47</sup> Clifford Chance, above n40.

<sup>48</sup> CMS-LawNow, ‘When the Dust Settles: Cross-border Restructuring and Insolvency after Brexit’ (20 September 2016), <<http://www.cms-lawnow.com/ealerts/2016/09/when-the-dust-settles-crossborder-restructuring-and-insolvency-after-brexit>>.

<sup>49</sup> Paul J. Omar, The Extra-Territorial Reach of the European Insolvency Regulation, 2007 (18)2 *International*

with the EU. In the absence of choice of law rules, there is no guarantee that the domestic rules of different jurisdictions with various jurisdictional claims would provide for consistency of outcome, thus resulting in inconsistencies and uncertainty among the nations involved post-Brexit.

The choice of law regime within the EU consists of systemic complexity and incoherence on both a theoretical and practical level.<sup>50</sup> The jurisprudence of the EU would impose new limitations in terms of the law applicable in the courts of the UK post-Brexit. Since the Insolvency Regulation would no longer be applicable in the UK, national law with substantive differences, disparate underlying policies and various protected interests in the systems of insolvency law<sup>51</sup> would be relied on. There will be ensuing uncertainty not only as to the applicable law but also, as to whether the strong protection of third parties' rights in rem and set-off rights can be maintained.<sup>52</sup> There would no longer be a judicial obligation to apply EU jurisprudence by the UK nor would the judgements of the EU Court of Justice directly bind the UK. When the applicable insolvency law is to be determined according to the national rules of cross-border insolvency law, the reliance instigates great uncertainty in the recognition and enforcement of insolvency proceedings and judgements within individual EU Member States whose rules conflict with the UK and vice-versa. The ensuing inconsistent decisions and conflicting judgements in cases of multi-jurisdictional international bank insolvency would have no legal certainty. The institutional differences and disparities between insolvency laws will ensue in new conflicts in respect of the substantive law to govern the distribution of proceeds, the ranking of claims, and the subsidiary rights remaining after the end of insolvency proceedings in international bank insolvency. The existence of institutional differences in the overall legal system of the country may impact on formal insolvency law and compound the disparities between insolvency laws in particular jurisdictions.<sup>53</sup> There is the opportunity for conflicts of substantive law in the legal nature of acts detrimental to creditors' interest which may be declared void, voidable or unenforceable at the instance of the presiding court.<sup>54</sup> The struggle in deciding the outcome of these issues without choice of law rules complicates the determination of the law applicable. While the Insolvency Regulation intended to have effect without conflict between domestic rules,<sup>55</sup> the non-member State status of the UK results in greater reliance on domestic rules of jurisdiction. These domestic rules decide the primacy of rules when there is conflict, and the extent that other systems of rules will have recognition and be given effect within the host jurisdiction.<sup>56</sup> The uncertainty of outcomes affects the extent that the systems of common law rules will be recognized by the EU and given effect if the host jurisdiction of the international bank is located in the UK. As a consequence, the determination of the law applicable in a choice of law process is no longer subject to reciprocity, and must involve a multilateral consideration of the appropriateness of the law applicable.<sup>57</sup>

Finally, the implications of Brexit would include that the mandatory duties of communication and cooperation between insolvency practitioners and courts are without a legal basis.<sup>58</sup> The main pillar of the EU insolvency framework lies in the recast EU Insolvency Regulation (EIR)<sup>59</sup> which focuses on the principle of coordination and communication between the insolvency office holders appointed in the insolvency proceedings. The reliance of the insolvency office-holder on the domestic law of conflicting jurisdictions in which recognition is sought would result in disparity and different outcomes, and instigate

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*Company and Commercial Law Review* 57, 63.

<sup>50</sup> Reimann, above n34, 518.

<sup>51</sup> Bob Wessels, *International Insolvency Law* (Kluwer Law International, 2<sup>nd</sup> ed, 2006), 5.

<sup>52</sup> Bob Wessels, 'Brexit and its Consequences for European Insolvency Law' on Bob Wessels, *Leiden Law Blog* (March 2, 2016) <<http://leidenlawblog.nl/articles/brexit-and-its-consequences-for-european-insolvency-law>>.

<sup>53</sup> Bob Wessels, *International Insolvency Law*, (2<sup>nd</sup> edn, 2006), 221.

<sup>54</sup> See also Miguel Virgos & Etienne Schmidt, (1996) 'Report on the Convention on Insolvency Proceedings', Virgos-Schmidt Report, 63.

<sup>55</sup> Omar, above n22.

<sup>56</sup> Paul Omar, 'The European Insolvency Regulation 2000: A Paradigm of International Insolvency Cooperation', (2003) 15(1) *Bond Law Review* 214, 234.

<sup>57</sup> See generally Ronald H. Graveson, *Conflict of Laws*, (Sweet and Maxwell, 7th ed., 1974); Peter Stone, *EU Private International Law: Harmonization of Laws* (Elgar European Law, 2006).

<sup>58</sup> Bob Wessels, 'Brexit and its Consequences for European Insolvency Law' on Bob Wessels, *Leiden Law Blog* (March 2, 2016) <<http://leidenlawblog.nl/articles/brexit-and-its-consequences-for-european-insolvency-law>>.

<sup>59</sup> European Commission, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (Recast) [2015] OJ L 141/19.

greater impediments to the recognition of foreign insolvency proceedings and judgements. The new choice of law issues in international bank insolvency post-Brexit give rise to several impediments, in particular those concerning the coordination between multiple jurisdictions and the inadequate protection of creditors<sup>60</sup> when there is no longer automatic recognition of foreign insolvency proceedings and judgements. In the Insolvency Regulation, international insolvency proceedings can be effectively conducted only if the States concerned recognize the jurisdiction of the courts of the State of the opening of the proceedings, the powers of their liquidators and the effects of their judgements. The extensive grounds of jurisdiction that result in overlapping and conflicting proceedings are inseparable from the traditional legal context of cross-border insolvency.<sup>61</sup> However, the cross-border insolvency provisions that may be applicable post-Brexit would not necessarily assist in the case of cross-border bank insolvency with the opening of multiple concurrent proceedings in the EU and the UK.<sup>62</sup> The English cross-border insolvency provisions (including the Cross-Border Insolvency Regulations 2006 which adopts the UNCITRAL Model Law, s426 Insolvency Act and the common law recognition rules) would not necessarily be of assistance in the case of multiple openings of insolvency proceedings of an international bank with conflicts of jurisdiction in the EU and the UK.<sup>63</sup> As a consequence, there would be dependence on domestic insolvency laws of the jurisdictions in question which would, most likely, result in an incongruent approach. The recent banking crisis in Europe has highlighted the significant obstacles in the current regime when effective cooperation and coordination among national regimes has not occurred. The uncertainty and instability has been and continues to be problematic in international bank insolvency cases where choice of law issues persist in national insolvency regimes. The innovation and harmonization of substantive choice of law rules would contribute to increasing the efficiency and effectiveness of insolvency proceedings, the predictability of the internal market, and foster greater confidence in the insolvency systems of the EU and UK. The various conflicts abovementioned have exposed the need for standard international rules<sup>64</sup> to resolve choice of law issues in international bank insolvency.

#### *The Contribution of UNCITRAL to Choice of Law Rules in International Bank Insolvency*

The current study of an international convention in international insolvency presents the opportunity to conceptualize an approach that can greatly assist other global leaders by addressing the choice of law issues in the cross-border insolvency of large, complex financial institutions. The concept of an international convention in international insolvency by UNCITRAL provides the ideal platform for the formulation of detailed and predictable substantive choice of law rules.<sup>65</sup> Although the Model Law envisages situations where proceedings may cause conflicts in concurrent proceedings between foreign jurisdictions, the choice of law issues are left open.<sup>66</sup> When the national law may apply its own laws or otherwise foreign laws that concede to territorial elements, this is likely to lead to more cross-border insolvency litigation whereby questions of choice of law in insolvency will become more frequent<sup>67</sup> post-Brexit. Indeed, ‘a treaty-based approach may have a serious gap in its coverage if it does not deal by its terms with the issue of how insolvencies arising from jurisdictions outside the particular region in question should be addressed to the extent that such foreign insolvencies intersect with insolvencies in the region itself.’<sup>68</sup> This critical issue is

<sup>60</sup> Dobah Care, ‘Le Systeme Canadien et le Systeme Europeen’, (LLM Thesis, Universite de Montreal, 2007).

<sup>61</sup> Jonas Israel, *European Cross-border Insolvency Regulation*, (Intersentia, Antwerpen-Oxford, 2005), 36.

<sup>62</sup> Ashurst, ‘Brexit: Potential Impact on the UK Banking Industry’ (1 March 2016), <<https://www.ashurst.com/en/news-and-insights/insights/brexit-potential-impact-on-the-uk-banking-industry/>>.

<sup>63</sup> Hogan Lovells, above n3. See also Stefan Remal, Guildhall Chambers, ‘Future-proofing Against Brexit in Insolvency Cases’ (November 2016) <<http://www.guildhallchambers.co.uk/uploadedFiles/InsolvencyBrexit2016SR.pdf>>, 8; The Insolvency Service, ‘Summary of Responses: A Review of the Corporate Insolvency Framework’ (25 May 2016), <<https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>>, 157.

<sup>64</sup> Michael H. Krimminger, ‘The Resolution of Cross-border Banks: Issues for Deposit Insurers and Proposals for Co-operation’, (2008) 4(4) *Journal of Financial Stability* 376, 379.

<sup>65</sup> Israel, above n61, 89.

<sup>66</sup> Jenny Clift, ‘The UNCITRAL Model Law on Cross-border Insolvency — A Legislative Framework to Facilitate Coordination and Cooperation in Cross-border Insolvency’, (2004) 12 *Tulane Journal of International and Comparative Law* 307, 334.

<sup>67</sup> Ibid.

<sup>68</sup> Steven Kargman, ‘Emerging Economies and Cross-Border Insolvency Regimes: Missing BRICS in the

highly relevant to the EU and UK in the absence of substantive choice of law rules to resolve the inevitable multi-jurisdictional international bank insolvency conflicts post-Brexit.

The absence of choice of law rules in international bank insolvency is, arguably, most prevalent in times of financial and banking crises. When there is worldwide uncertainty as to the answers to complex choice of law issues, the principle of *pari passu* remains an elusive ideal because of the limitations of the law. The certainty of choice of law rules in international bank insolvency is fundamental in resolving the inevitable jurisdictional conflicts of law issues that will arise between the EU and the UK post-Brexit, and in times of crises. The choice of law problems that has been created by private international law<sup>69</sup> principles has been ineffective in resolving the multi-jurisdictional conflicts<sup>70</sup> in cross-border bank insolvencies. In international bank insolvency, the bank's branches and subsidiaries cross various jurisdictions with assets abroad, including claims against companies in various jurisdictions, and also insolvent subsidiaries whereby sovereign states are confronted with a collective action dilemma.<sup>71</sup> In the determination of the law applicable in international bank insolvency post-Brexit, the paradigm of co-operation breaks with the 'all or nothing' attitude prevalent under traditional approaches underlying international insolvency.<sup>72</sup> As a multinational bank operates as an integrated global unit,<sup>73</sup> the conflicts have created additional problems which are due to the lack of harmonisation of conflicts rules.<sup>74</sup> This lack of harmonization may create difficulties in the enforcement of legal rights and obligations, conflicting judgements and inconsistent decisions. The risk of inconsistent judgments that inevitably arise from a failure to address international problems in a single forum or with a central, main proceeding<sup>75</sup> is inevitable in the absence of substantive choice of law rules. In *Re Maxwell Communication Corporation*,<sup>76</sup> the issue of which law was applicable to a bankruptcy preference instigated extensive litigation in the US and England. However, 'a clear choice of law rule incorporated into the state's insolvency system could have avoided the expense and delay of litigation'.<sup>77</sup> In consideration of this, it may be argued that specific solutions depend on the 'convergence of national laws, adoption of an international substantive rule, or adoption of an international choice-of-law, choice-of-forum rule'.<sup>78</sup> At present, the incoherency in international insolvencies destroys asset value, whereby there is no uniformity for the most equitable and efficient treatment of creditors.<sup>79</sup>

The contribution that UNCITRAL can make in addressing and formulating substantive choice of law rules in international bank insolvency assists its' aims in firstly, the harmonization and modernization of insolvency law and, secondly, the promotion of cooperation and coordination in cross-border insolvency

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International Insolvency Architecture (Part II)' (2013) 7(1) *Insolvency and Restructuring International* 7; Gregory Baer, 'Towards an International Convention: Issues, Options and Feasibility Considerations', (2016) 17(1) *Business Law International* 5, 8.

<sup>69</sup> Michael J. Whincorp & Mary Keyes, *Policy and Pragmatism in the Conflict of Laws* (Dartmouth Publishing Ltd, 2001), 188.

<sup>70</sup> Ibid.

<sup>71</sup> David Darrell Evanoff & George G. Kaufman (eds), *Systemic Financial Crises: Resolving Large Bank Insolvencies*, (World Scientific Publishing Co. Pty Ltd, 2005), 314.

<sup>72</sup> Israel, above n61, 91.

<sup>73</sup> Eva H.G. Hupkes, 'The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada', (Kluwer Law International, 2000), 14.

<sup>74</sup> Talian Einhorn 'American vs European Private International Law- The Case for a Model Conflict of Laws Act (MCLA)', in *Convergence and Divergence in Private International Law*, (Eleven International Publishing, 2010), 34.

<sup>75</sup> Jay Lawrence Westbrook, 'Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum', 65 (1991) *American Bankruptcy Law Journal* 457.

<sup>76</sup> *Re Maxwell Communication Corporation plc* (No 2) [1992] BCC 757].

<sup>77</sup> *Re Maxwell Communication Corporation plc* (No 2) [1992] BCC 757] at [392].

<sup>78</sup> Jay Lawrence Westbrook, 'A Global Solution to Multinational Default', 98 (2000) *Michigan Law Review* 2276, 2318. See also Jay Lawrence Westbrook, 'Universalism and Choice of Law', 23 (2005) *Penn State International Law Review* 625; Charles. W Mooney, Jr., 'Harmonizing Choice of Law Rules for International Insolvency Cases: Virtual Territoriality, Virtual Universalism, and the Problem of Local Interests', 9(1) (2014) *Brooklyn Journal of Corporate, Financial & Commercial Law* 120.

<sup>79</sup> Elizabeth K. Somers, 'The Model International Insolvency Cooperation Act', (2011) 6(4) *American University International Law Review* 677, 701-2.

proceedings.<sup>80</sup> The international insolvency architecture allows the change from the jurisdictional-selecting approach of the conflict of law<sup>81</sup> to a substantive choice of law approach. Within the new paradigm, the existence of choice of law rules in international bank insolvency can reside to ensure greater legal certainty, resolution of multi-jurisdictional conflicts and procedural fairness. The economic underpinning of insolvency has resulted in national sovereignty and strong resistance in order to prevent national sovereignty from being undermined. This adverse consequence of the jurisdiction being able to select rules tends to benefit certain interests to the detriment of others.<sup>82</sup> In recent times, traditional views of sovereignty have given way to a growing consensus on the need for comity.<sup>83</sup> However, the concept of comity is of little guidance to decide the law applicable in choice of law decisions.<sup>84</sup> The need for reform in insolvency law to ‘assist sovereignty-sensitive states to acclimate to the extraterritorial reach of foreign laws’<sup>85</sup> is imperative in resolving choice of law conflicts in international bank insolvency post-Brexit. While there has been some support in the Working Group for treating choice of law as a separate topic, it was generally agreed that it should be approached, at least in the immediate future, by reference to those aspects of choice of law necessary to address enterprise group insolvency and directors’ obligations.<sup>86</sup> The architectural development of choice of law by UNCITRAL presents the significant opportunity to assist other global leaders by addressing substantive choice of law rules in international bank insolvency as a future mandate. In international insolvency, international legal rules are in place today that were seemingly not possible ten years ago, and would have been unimaginable ten years before that.<sup>87</sup> The work of UNCITRAL forms a strong foundation upon which new insolvency law topics can be developed.<sup>88</sup> The form and function of UNCITRAL, its’ composition, and its’ concept of an international convention is best equipped to accomplish the certainty of choice of law rules in international bank insolvency when the time comes. The contribution of UNCITRAL to future work in respect of this and subsequent choice of law rules will significantly contribute to a wider harmonization and modernization of insolvency law, achieve a greater degree of harmony within national systems’ conflict of laws, and ensure considerable certainty in the future world of multi-jurisdictional insolvencies. The contribution of UNCITRAL to address substantive choice of law rules in international bank insolvency would have a profound and far-reaching impact on jurisdictions around the world and on the international economy.

<sup>80</sup> Jenny Clift, ‘Choice of Law and the UNCITRAL Harmonization Process’, 9(1) (2014) *Brooklyn Journal of Corporate, Financial and Commercial Law* 20.

<sup>81</sup> Rodolfo de Nova, ‘Glancing at the Content of Substantive Rules under the Jurisdiction-Selecting Approach’, (1977) 41(2) *Law and Contemporary Problems* 1, 27.

<sup>82</sup> Ibid. The consequence stems from the analysis of the banking group in terms of general jurisdiction which regards states interests as relevant to private international law. This approach examines the relationship between the state and the banking group, and questions whether the exercise of jurisdiction over the group can be justified, in terms of state policy or political rights. One shortcoming of this approach is that it does not consider the complexity, conflicts and difficulties prevalent in international bank insolvencies or their complex legal structures which may be formed to evade state policy.

<sup>83</sup> Fletcher, above n4, 433.

<sup>84</sup> Buxbaum, above n33.

<sup>85</sup> John Pottow, ‘Procedural Incrementalism: A Model for International Bankruptcy’, (2006) 45(4) *Virginia Journal of International Law* 936, 1011.

<sup>86</sup> United Nations Commission of International Trade Law, Report of Working Group V (Insolvency Law), Vienna, Forty-Fourth Session, 9-13<sup>th</sup> November, 2009, UN Doc. No. A/CN.9/686, 22.

<sup>87</sup> Westbrook, above n78, 2328.

<sup>88</sup> Clift, above n80, 47.

## Session 7 — Reform of investor-state dispute settlement

### *The Paradox of International Investment Law: Trivializing the Development Objective Underlying International Investment Agreements in Investor-State Dispute Settlement*

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#### I. Introduction

The *paradox* of international investment law is the contradiction very much real and alive in international investment treaty law and arbitration. International investment agreements (IIAs) and arbitration are justified in terms of their supposed role in promoting the development of the host states through foreign investment attraction. Nevertheless, investor-state arbitration defines the concept of investment and adopts an approach to the settlement of investment disputes in terms which take out or trivialize the development objective underlying the IIA regime. In other words, the *paradox* of international investment law is about its opposite and contradictory features. This is revealed in particular in investment treaty arbitration, namely the fact that the very development reason that is used to justify the investment treaty regime is treated peripherally, in fact, as irrelevant in defining the concept of investment and in deciding the issue whether an investment should enjoy protection under an IIA if it does not make contribution to the development of the host state. This is the paradox with which this article is concerned.<sup>1</sup> Should contribution to development be treated as relevant in the definition of the concept of investment in investor-state dispute settlement? Should an investor lose the rights of protection under an IIA if its covered investment does not make a contribution to the development of the host state? I argue that in theory and in practice states enter into investment treaties to promote their development and not just to protect investment as an end in itself. Thus, there is the need for a *sustainable investment dispute settlement*; that is resolving investment disputes in manner that guarantee investors the enjoyment of rights under the applicable IIAs without compromising states' development interest in entering into the IIA. The continued existence and relevance of the IIA regime depends on its ability to balance and sustain the protection of the competing interests that underlie its construction. The IIA regime cannot be sustainable if the protection of one its competing interests becomes the primary occupation of investor-state arbitration to the neglect of other equally embedded interests.

The IIAs are premised on at least two disputed<sup>2</sup> related rationales. The first conventional supposition is that foreign investment leads to development and that IIAs are necessary to protect and thereby attract foreign investment.<sup>3</sup> Based on this premise and other reasons, most countries have liberalised or strengthened their legal regimes for the promotion and protection of foreign investment and international law on foreign investment has been preoccupied with the treatment to be accorded to foreign investment

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<sup>1</sup> My thinking here was influenced by Hans Morgenthau, "What Is the National Interest of the United States?" (1952) 282 *The Annals of the American Academy of Political and Social Science* 1; and Martin Loughlin and Neil Walker (eds), *The Paradox of Constitutionalism: Constituent Power and Constitutional Form* (Oxford University Press, 2007).

<sup>2</sup> M Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (Cambridge University Press, 2015) at 81-86.

<sup>3</sup> For the rationales of the IIA regime see: Sornarajah, *Resistance and Change* *ibid.*, p. 81, 107-108; M Sornarajah, *The International Law on Foreign Investment* (3edn Cambridge University Press, 2010) 82-88; Andrew T Guzman, 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1997) 38 *Virginia Journal of International Law* 639; Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press, 2010); Kenneth J Vandeveld, *Bilateral Investment Treaties: History, Policy, and Interpretation* (Oxford University Press, 2010); Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press, 2008) and Reinisch August (ed), *Standards of Investment Protection* (Oxford University Press, 2008).

and associated private property rights.<sup>4</sup> The strengthening of the legal regime for foreign investment at the international level is reflected in the growth of IIAs which reached 3,304 by the end of 2015.<sup>5</sup>

The stated premise of the first IIA, reached between Germany and Pakistan in 1959, was the states' conviction that it was likely to promote investment, encourage private industrial and financial enterprise and *increase the prosperity of both states*.<sup>6</sup> The Convention on the Settlement of Investment Disputes between States and Nationals of Other States of the International Centre for the Settlement of Investment Disputes (ICSID Convention)<sup>7</sup> expresses the idea that there was a need for international cooperation and private international investment *for the attainment of economic development*. The IIAs, it is claimed, can attract foreign investment by establishing standards of investment protection such as fair and equitable treatment, full protection and security, national treatment, most-favoured-nation treatment, repatriation of investment returns and prohibition against direct and indirect expropriation.<sup>8</sup>

A second argument is that host states' judicial systems cannot provide adequate protection for foreign investors. Therefore, to ensure that these standards of investment protection are 'effectively' enforced, IIAs make provision for investment arbitration to settle investment disputes between states and foreign investors.<sup>9</sup> By the end of 2015, the number of investor-state dispute settlement claims reached 696 with 107 states as respondents.<sup>10</sup>

In spite of the fact that developing states enter into IIAs to attract foreign investment for development<sup>11</sup>, investment tribunals are divided as to whether an investment's contribution to development is an element in the definition of the concept of investment. They are consequently not agreed on whether an investment should be entitled to protection under an IIA if it does not make any contribution to the development of the host state. As Dr Diane Desierto stated<sup>12</sup>:

[T]he concept of development figures in two highly polemical questions that have become a staple in contemporary investment arbitral disputes. The first question asks whether development should be treated as an essential element or criterion (rather than simply a descriptive feature) to establish the existence of an "investment" to which the international investment agreement (IIA) would apply ... The second question inquires if the state's regulatory prerogative to pursue development objectives

<sup>4</sup> Dominic N Dagbanja, "The Investment Treaty Regime and Development Policy in Ghana: Analysis in Constitutionalism and General International Law" in Andrea K Bjorklund (ed), *Yearbook on International Investment Law and Policy 2014-2015* (Oxford University Press 2016) 405.

<sup>5</sup> UNCTAD, *World Investment Report 2016: Investor Nationality: Policy Challenges* (United Nations Publication, 2016) xii and 104.

<sup>6</sup> *Pakistan and Federal Republic of Germany Treaty for the Promotion and Protection of Investments*, signed at Bonn, on 25 November 1959.

<sup>7</sup> *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* entry into force on 14 October 1966.

<sup>8</sup> For the history behind the IIA regime and the justification for this regime see Sornarajah, *Resistance and Change in the International Law on Foreign Investment* at 78-135; Ignaz Seidl-Hohenveldern "The ABS-Shawcross Draft Convention to Protect Private Foreign Investment: Comments on the Round Table" (1961) 10 *Journal of Public Law* 100.

<sup>9</sup> Christopher Dugan et al, *Investor-State Arbitration* (Oxford University Press, Oxford, 2008); and Dodge, William S, "Investment Treaties between Developed States: The Dilemma of Dispute Resolution" in Rogers, Catherine A, and Alford, Roger P (eds), *The Future of Investment Arbitration* (Oxford University Press: New York, 2009) 165; M Sornarajah, *Resistance and Change*, See above note 3, 136-190; ; M Sornarajah, "Evolution or Revolution in International Investment Arbitration" in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, Cambridge 2011) 631; M Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer Law International, 2000)

<sup>10</sup> UNCTAD, *World Investment Report 2016*, See note 5 above.

<sup>11</sup> Sornarajah, *Resistance and Change*, See note 3 above; Sornarajah, *Law on Foreign Investment*, See note 3 above; Salacuse, *Law of Investment Treaties*, See note 3 above; and Guzman, *Why LDCs Sign Treaties*, See note 3 above.

<sup>12</sup> Diane A. Desierto, 'Deciding International Investment Agreement Applicability: The Development Argument in Investment' in Freya Baetbs (ed), *Investment Law within International Law: Integrationist Perspectives* (Cambridge University Press, 2013) 240, 240-241.



form part of subject matter that can be deemed excluded from the applicability of an IIA ... [T]hese questions speak to a much broader *problématique* about the extent of applicability of an IIA to an investor-state dispute when the host state has to contend with challenging adverse development situations arising during the life of an investment.

Professor Muthucumaraswamy Sornarajah articulated a similar point:<sup>13</sup>

It is not far-fetched to argue that there is an ideological schism that dominates the debate on the definition of investment. Those who seek to confine the jurisdiction of tribunals would seek to define consent of states as being confined to investments that clearly promote economic development, whereas the expansionists would not like to see jurisdiction limited in this manner. The explanation of the rift between these two views does not turn only on the interpretation of words, but on the imputation of policy objectives.

This article contributes to a new way of assessing whether an investment's contribution to development should be taken into consideration in defining the concept of investment and whether a lack of such contribution should deny an investment legal protection based on textual rather than historical and policy analysis. The article reviews various international texts and conventions on investment and trade to ascertain the extent to which development is an objective in those treaties and the role that such an objective might play in commercial and investment disputes settlement.

Based on purposive interpretation and analysis, I argue that the substantive obligation to protect an investment is an economic exchange or *offer* for the contribution an investment will make to development (*consideration*) for the host states. Therefore, contribution to development or lack of it must be taken into consideration in defining an investment and in deciding whether the investment should be entitled to protection. I point out the centrality of development as one of the purposes for the construction of the IIA regime and the need for that purpose to be factored into investment disputes settlement. I make a purposive case for sustainable investment disputes settlement: an approach to dispute resolution that takes into account the rights of private business and commercial parties to the dispute without compromising any of the purposes of the governing legal text and the autonomy of states to regulate generally to promote development.

## II. *Development as Objective of International Investment Agreements*

A case can only be made for the development objective to be factored into investor-state dispute settlement if it is shown that objective is central and inherent part of the investment treaty regime. This section does that.

Liberal economic theory justifies free trade and investment in terms of development.<sup>14</sup> According to Professor Sornarajah:<sup>15</sup>

Independently of the structuring of the theory of internationalization of foreign investment contracts through the inclusion of appropriate clauses that increase external contacts of the contracts, policy grounds have been developed to justify the theory of internationalization. The policy grounds are founded in clearly classical economic views that foreign investment brings unmitigated blessings to a developing country, and that flows of such investment should be promoted through legal protection given through international law ...

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<sup>13</sup> Sornarajah, *Resistance and Change*, See note 3 above, p. 162.

<sup>14</sup> Sornarajah, *Resistance and Change*, See note 3 above, 19-31; Jane Kelsey, *The Fire Economy: New Zealand's Reckoning* (Bridget William Books, 2015), 121-149; Jane Kelsey, *Reclaiming the Future: New Zealand the Global Economy* (Bridget Williams Books, 2000), p. 200.

<sup>15</sup> *Resistance* at 107-108.

The justifications concentrate on the benefits of foreign investment. The benefits brought by foreign investment include technical assistance, transfer of new technology, the building of infrastructure and new employment for local personnel. Such flows would not take place if there was instability in the legal regime that covered the foreign investment. The considerable financial risks involved in making investments in sectors like petroleum required that there should be security for such investments. Security and stability are essential because of the long duration of the contract. Since the laws of the host state were inherently unstable, it was necessary to rectify this situation by constructing stable rules that promoted contractual stability. These are long-standing justifications for the protection of foreign investment through internationalization.

Global policymakers and many trade and investment scholars share this view that there is a relationship between foreign investment and development. The basic proposition on why there is the need for friendly policies and laws on foreign investment has been summed up by Kofi Annan, former United Nations Secretary-General in the following words: “[w]ith its enormous potential to create jobs, raise productivity, enhance exports and transfer technology, foreign direct investment is a vital factor in the long-term economic development”<sup>16</sup> of developing countries. Annan also stated that outward investment offers additional avenues for developing countries to link up to global markets and production systems. These investments, if managed properly, according to Annan, could help firms to access markets, natural resources, foreign capital, technology or various intangible assets that are essential to their competitiveness that may not be readily available in their home countries.<sup>17</sup>

Professor Terutomo Ozawa argues that while an outward-orientation alone is not a sufficient condition for rapid development, it does create a climate favourable for the transfer by transnational corporations, and the absorption by local enterprises of modern managerial, production and marketing technologies which are the *sine qua non* of industrial modernization.<sup>18</sup> In the opinion of Ozawa, any developing country serious about raising living standards “must open its economy so as to avail itself of opportunities to trade, interact with and learn from the already advanced.”<sup>19</sup> This is because the advanced countries are not only “the rich reservoirs of industrial technology, information and experiences which the followers can tap,”<sup>20</sup> “[t]hey also provide the promising export markets from which the less developed can earn precious hard currencies.”<sup>21</sup> Thus, as summed up by Professor Sornarajah, the “premise on which investment treaties are made is that foreign investment leads to economic development and that foreign investment treaties lead to greater flows of foreign investment.”<sup>22</sup> However, in theory and practice this is not so.<sup>23</sup> Professor Ozawa’s claim as to technology transfer arising from trade and investment is quite exaggerated to the extent that international agreements (such as Commission Regulation (EU) No 316/2014) restrict or limit technology transfer.<sup>24</sup>

There are many reasons for the development of IIAs and arbitration.<sup>25</sup> However, from an interpretive perspective there cannot be a better source to explain the objectives of IIAs than their texts. The preambles,

<sup>16</sup> Kofi Annan, “Foreword” in UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (United Nations, 2003) iii.

<sup>17</sup> Ibid.

<sup>18</sup> Terutomo Ozawa, “Foreign Direct Investment and Economic Development” (1992) 1 *Transnational Corporations* 27.

<sup>19</sup> Ibid., 27.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Sornarajah, *Law on Foreign Investment*, See above note 3, p. 229.

<sup>23</sup> M Sornarajah and Leo Trakman, “A Polemic: The Cases for and Against Investment Liberalization” in Leon A Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (Oxford University Press, 2013) 499, p. 504.

<sup>24</sup> Commission Regulation (EU) No 316/2014 of 21 March 2014 < <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0316&from=EN>>.

<sup>25</sup> Sornarajah, resistance 78-135 and 136-190; Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, 2011); Kate Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (Cambridge University Press, 2013); Antony Anghie, *Imperialism, Sovereignty and the Making of International Law* (Cambridge University Press, 2005) 445; Kojo Yelapaala “Fundamentalism in public health and safety in bilateral investment treaties [Part I]” (2008) 3(1) *Asian Journal of WTO and International Health Law and Policy* 242 at 249; and Dominic N Dagbanja, “The Limitation

and to a limited extent, the substantive provisions of investment and trade agreements justify trade and investment regimes in terms of development. This is reflected in treaties entered into not only between developing countries and developed countries, but also within and among developed countries and within and among developing countries themselves. For example, Ghana is a party to a number of investment treaties with United Kingdom, Netherlands, Denmark, China and Malaysia, among others. The preambles to these investment treaties state that they are intended to create favourable conditions for foreign investment because of its role in development. Strengthening cooperation between private enterprises of the contracting parties is also an important objective of Ghana's investment treaty framework..

The objective of the Ghana-United Kingdom investment treaty<sup>26</sup> was “to create favourable conditions for greater investments”.<sup>27</sup> The states parties assumed that the “encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiative and will increase prosperity”.<sup>28</sup> The Ghana-Netherlands investment treaty<sup>29</sup> was meant “to strengthen the traditional ties of friendship”<sup>30</sup> between the two countries and “to extend and intensify the economic relations between them particularly with respect to investments”.<sup>31</sup> An agreement upon the treatment to be accorded to foreign investments was considered necessary to stimulate the flow of capital and technology for development.

The Ghana-Malaysia investment treaty<sup>32</sup> was intended “to expand and strengthen economic and industrial cooperation on a long term basis, and in particular, to create favourable conditions for investments.”<sup>33</sup> The parties recognized the need to protect investments “to stimulate the flow of investments and individual business initiative with a view to promoting ... economic prosperity”.<sup>34</sup> The Ghana-China investment treaty<sup>35</sup> expressed the parties' desire “to encourage, protect and create favourable conditions for investment”,<sup>36</sup> “based on the principles of mutual respect for sovereignty, equality and mutual benefit and for the purpose of the development of economic cooperation between both States.”<sup>37</sup>

The stated objective of all these investment treaties in providing the legal basis for the protection of foreign investment is explicitly linked to development cooperation, economic development, increased prosperity and stimulation of the flow of capital and technology. Therefore, the search for development is an objective of Ghana and its contracting parties' investment treaties as is with other developing countries. The investment treaties never pretend to present the protection of foreign investment as an end in itself. The articulation of development as an objective of foreign investment promotion and protection necessitates the integration of development concerns into the enforcement of investment treaties.<sup>38</sup>

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on Sovereign Regulatory Autonomy and Internationalization of Investment Protection by Treaty: An African Perspective” (2015) 60(1) *Journal of African Law* 1.

<sup>26</sup> *Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Ghana for the Promotion and Protection of Investments* (signed 22 March 1989, entered into force 25 October 1991 (“Ghana-United Kingdom Investment Treaty”).

<sup>27</sup> *Ibid.*

<sup>28</sup> *Ibid.*

<sup>29</sup> *Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Ghana* (signed 31 March 1989, entered into force 1 July 1991 (“Ghana-Netherlands investment Treaty”).

<sup>30</sup> *Ibid.*, preamble.

<sup>31</sup> *Ibid.*

<sup>32</sup> *Agreement between the Government of the Republic of Ghana and the Government of Malaysia for the Promotion and Protection of Investments* (signed on 8 November 1996, entered into force 18 April 1997 (“Ghana-Malaysia Investment Treaty”).

<sup>33</sup> *Ibid.*, preamble.

<sup>34</sup> *Ibid.*, preamble.

<sup>35</sup> *Agreement between the People's Republic of China and the Government of the Republic of Ghana Concerning the Encouragement and Reciprocal Protection of Investments* (signed 12 October 1989, entered into force on 22 November 1991 (“Ghana-China Investment Treaty”).

<sup>36</sup> *Ibid.*, preamble.

<sup>37</sup> *Ibid.*

<sup>38</sup> Dagbanja, Investment Treaty Regime and Development Policy, See above not 4, 419-429.

The parties to the Agreement Establishing the World Trade Organisation<sup>39</sup> put development at the centre stage of trade promotion and protection when they stated in the very first paragraph of the preamble to the Agreement that the contracting parties’:

relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world’s resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development.

The WTO Agreement on Trade-Related Investment Measures reflects the members’ desire “to promote the expansion and progressive liberalisation of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners,” taking into account the particular “trade, development and financial needs” of developing countries.<sup>40</sup> The Trans-Pacific Partnership Agreement (TPPA) is a comprehensive regional agreement (among Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam) that is aimed at promoting “economic integration to liberalise trade and investment, bring economic growth and social benefits, create new opportunities for workers and businesses, contribute to raising living standards, benefit consumers, reduce poverty and promote sustainable growth.”<sup>41</sup> Very significantly the investment chapter in Article 9.16 recognizes the rights of member states to adopt, maintain or enforce measures to protect the environment and human health.

In relation to the objectives of international trade rules, Peter Van den Bosche and Werner Zdouc argue that “international trade can make a significant contribution to economic development and prosperity in developed as well as developing countries.”<sup>42</sup> In their opinion, international trade rules “are necessary” because “as a result of the greatly increased levels of trade in goods and services, the *protection and promotion of important social values* such as public health, a sustainable environment, consumer safety, cultural identity and minimum labour standards is no longer a purely national matter.”<sup>43</sup> I argue then that where the objective of attaining development is intimately and inherently embedded in these IIAs and trade agreements, a state that is party to them should be able to say a particular investment or commercial activity is not entitled to claim legal protection under the applicable treaty if the investment or commercial activity will not contribute to the development of the host state. This is because by these agreements reviewed herein, a business undertaken or transaction should only qualify as investment if it will make contribution to the development of the host. Indeed, by these agreements it is contribution to development from the perspective of the state that has entered into the investment treaties that is one of the primary criteria that constitute investment because that objective is one of the underlying reason states entered into these investment treaties.

### III. *The Contribution of Investment to Development and Investor-State Disputes Settlement*

This section is primarily concerned with investigating the importance that investment treaty arbitration attaches to development in settling investor-state disputes. The point made in this section is that, since states enter into investment agreements to promote a number of objectives including development yet development is not central in investment arbitral decision-making, states need to reconsider whether

<sup>39</sup> *Agreement Establishing the World Trade Organisation*, Marrakesh, 15 April 1994, <[https://www.wto.org/english/docs\\_e/legal\\_e/04-wto.pdf](https://www.wto.org/english/docs_e/legal_e/04-wto.pdf)>

<sup>40</sup> *Agreement on Trade-Related Investment Measures*, [https://www.wto.org/english/docs\\_e/legal\\_e/18-trims.pdf](https://www.wto.org/english/docs_e/legal_e/18-trims.pdf).

<sup>41</sup> *Trans-Pacific Partnership Agreement* <http://dfat.gov.au/trade/agreements/tpp/official-documents/Pages/official-documents.aspx>.

<sup>42</sup> Peter Van den Bosche and Werner Zdouc, *The Law and Policy of World Trade Organization* (3edn, Cambridge University Press, 2013), p. 30.

<sup>43</sup> *Ibid.*, p. 33 (emphasis original).

investment treaties and investment arbitration are the appropriate mechanisms to advance their development goals.

*A. Contribution of Investment to Development as a Non-essential Element of Investment*

The majority of known arbitral decisions hold the view that an investment does not need to contribute to the development of a host state before it can enjoy an investment treaty protection and that a state may not invoke an investment's lack of contribution to development as a defence for breach of an IIA.

In *Société Générale v Dominican Republic*<sup>44</sup> the investor argued that the Dominican Republic had expropriated its investments in an electricity distributor because the country failed to allow for electricity rate increases and to control rampant electricity theft. This claim was based on a bilateral investment agreement between the Dominican Republic and France.<sup>45</sup> The Dominican Republic objected to the Tribunal's jurisdiction. It argued that Société Générale had not made an investment that could be protected by the investment treaty because there was no contribution to the Republic's development as the preamble to the treaty envisaged. The preamble stated that the promotion and protection of investment between the two countries would stimulate the transfers of capital and technology "in the interest of their economic development."

The Tribunal constituted under the UNCITRAL Rules<sup>46</sup> held that to the extent that the shares, concessions under contract and claims and rights to any benefit having an economic value were involved in the dispute, they all qualified for protection independently of the manner in which they each contributed to stimulating the transfer of capital and technology. According to the Tribunal, the transfer of capital and technology was the "overall objective but not a specific requirement for each individual form of investment, which would be in any event most difficult to establish on a case-by-case basis."<sup>47</sup> The fact that the preamble set out the general objective of economic relationship between the two countries did not detract from the fact that every form of investment listed in the investment treaty qualified for protection whether it contributed to development or not.<sup>48</sup> The Tribunal's position denies the development objective of the IIA as revealed in its text.

In finding that the investor had made an investment, the Tribunal held that the principal objective of the transaction was the potential profitability of the investment in the hope that the electricity sector in the Dominican Republic would become financially viable since the investors were involved financial services and investment funds.<sup>49</sup> Finally, the Tribunal held that the "issue of specific contribution made to the local economy by a transaction of this kind might not be as easy to identify ... but this of course does not disqualify financial investments from protection"<sup>50</sup> under the treaty. In relation to the role of a preamble to determining substantive rights, the Tribunal held that a preamble sets out the general purposes and objectives of the Treaty but "cannot add substantive requirements to the provisions of the Treaty."<sup>51</sup> The Tribunal reasoned that preambles become necessary only "when the ordinary meaning of the text cannot be clearly established by the pertinent provisions themselves, which is not the case here"<sup>52</sup> because the applicable IIA defined investment non-exhaustively in the sense that it did not restrict the scope of application of the concept.<sup>53</sup> The position of the Tribunal as to when preambles become necessary is quite inaccurate and misleading. As I establish below, treaties are to be interpreted to promote their objects. Thus

<sup>44</sup> *Société Générale v. Dominican Republic*, LCIA Case No UN 7927, UNCITRAL Arbitration Rules, Award on Preliminary Objections to Jurisdiction 19 September 2008.

<sup>45</sup> *Agreement between the Government of the French Republic and the Government of the Dominican Republic on the Reciprocal Promotion and Protection of Investment* signed on 14 January 1999 and entry into force on 23 January 2003.

<sup>46</sup> *UNCITRAL Arbitration Rules* as revised in 2010.

<sup>47</sup> *Société Générale v. Dominican Republic*, See above note 44, at [33].

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.*, at [34].

<sup>50</sup> *Ibid.*, at [35].

<sup>51</sup> *Ibid.*, at [31].

<sup>52</sup> *Ibid.*, at [31].

<sup>53</sup> *Ibid.*, at [32].

to the extent that a treaty's object is stated in its preamble the substantive terms of the treaty must be interpreted in reference to the object as contained in the preamble. So preambles always be necessary to refer to so long as they contain the objects of the applicable treaties.

In *Conorzio Groupement LESI-DIPENTA v Algeria*,<sup>54</sup> the investor won a contract for the construction of a dam to provide drinking water for the city of Algiers. The regulatory institutions claimed they wanted to change the method of construction and suspended the contract. The contract was subsequently terminated a few years later because little progress was being made on the job. The investors alleged breach of the full protection and security provision of the investment treaty between Algeria and Italy<sup>55</sup> and sought damages flowing from cancellation of the contract. Algeria argued that the contract did not meet the definition of "investment" within the meaning of Article 25 of the ICSID Convention. According to Algeria, the claimant made no capital, material, or industrial contribution for the establishment of the worksite, which investments would have become the property of the state after completion of the contract. The Tribunal held that in deciding whether a contract is an investment within the meaning of Article 25 of the ICSID Convention, "it is not necessary that the investment contribute more specifically to the host country's economic development, something that is difficult to ascertain"<sup>56</sup>

Other cases hold a similar position as those above as to the relevance of contribution to development in investor-state dispute settlement. *Ceskoslovenska Obchodni Banka AS v Slovak Republic*<sup>57</sup> holds the view that the concept of investment should be interpreted broadly because the drafters of the ICSID Convention did not impose any restrictions on its meaning. The Preamble to the ICSID Convention declares that the contracting states have taken into consideration the need for international cooperation for 'economic development, and the role of private international investment therein'. It could be inferred, therefore, that an international transaction which "contributes to cooperation designed to promote the economic development of a Contracting State may be deemed to be an investment as that term is understood in the Convention."<sup>58</sup> However, the case also suggests that the parties' consent to the jurisdiction of ICSID is very important in determining a tribunal's jurisdiction, irrespective of whether or not a specific investment project made a contribution to a host country's development.<sup>59</sup>

The *Ceskoslovenska Obchodni Banka* tribunal ultimately decided that a two-fold test was to be applied in determining whether it had the competence to consider the merits of the claim: whether the dispute arose out of an investment within the meaning of the ICSID Convention and, if so, whether the dispute related to an investment as defined in the state parties' consent to ICSID's arbitration and in their reference to the bilateral investment agreement<sup>60</sup> and the pertinent definitions contained in the agreement.<sup>61</sup> In effect, the contribution of the loan, which was the subject matter of the dispute, to Slovak Republic's development was irrelevant in determining whether the transaction constituted an investment or not.

A couple of other recent cases demonstrates that contribution to development is not central in investment treaty arbitration. In *Electrabel SA v Republic of Hungary*,<sup>62</sup> the Tribunal while identifying profit and return as necessary and integral elements of an "investment" held that although "the economic development of the host State is one of the objectives of the ICSID Convention and a desirable consequence

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<sup>54</sup> *Conorzio Groupement LESI-DIPENTA v Algeria*, ICSID Case No ARB/03/08, Award (10 January 2005).

<sup>55</sup> *Agreement on the Promotion and Reciprocal Protection of Investments between Algeria and Italy*, entry into on 26 force November 1993.

<sup>56</sup> *Conorzio Groupement LESI-DIPENTA v. Algeria*, supra note 81, at [13](iv)].

<sup>57</sup> *Ceskoslovenska Obchodni Banka AS v Slovak Republic*, ICSID Case No ARB/97/4, (Decision of the Tribunal on Objections to Jurisdiction, 24 May 1999, at [64].

<sup>58</sup> Ibid.

<sup>59</sup> Ibid., at [66].

<sup>60</sup> *Agreement between the Government of the Slovak Republic and the Government of the Czech Republic Regarding the Promotion and Reciprocal Protection of Investments* signed on 23 November 1992, entered into force on January 1993.

<sup>61</sup> *Ceskoslovenska v Slovak Republic*, See note 57 above, at [68].

<sup>62</sup> *Electrabel SA v Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability (30 November 2012).

of the investment ... it is not necessarily an element of an investment.”<sup>63</sup> Similarly, the Tribunal stated in *Saba Fakes v Turkey*<sup>64</sup> that it was not convinced.<sup>65</sup>

... that a contribution to the host State’s economic development constitutes a criterion of an investment within the framework of the ICSID Convention. Those tribunals that have considered this element as a separate requirement for the definition of an investment ... have mainly relied on the preamble to the ICSID Convention to support their conclusions. The present Tribunal observes that while the preamble refers to the ‘*need for international cooperation for economic development*,’ it would be excessive to attribute to this reference a meaning and function that is not obviously apparent from its wording. In the Tribunal’s opinion, *while the economic development of a host State is one of the proclaimed objectives of the ICSID Convention, this objective is not in and of itself an independent criterion for the definition of an investment*. The promotion and protection of investments in host States is expected to contribute to their economic development. Such development is an expected consequence, not a separate requirement, of the investment projects carried out by a number of investors in the aggregate. Taken in isolation, certain individual investments might be useful to the State and to the investor itself; certain might not. Certain investments expected to be fruitful may turn out to be economic disasters. They do not fall, for that reason alone, outside the ambit of the concept of investment.

The above thus treat an investment’s contribution to development as an irrelevant contribution in defining investment. Such a position is untenable because investment tribunals have an obligation to interpret a treaty in light of its objectives, which includes the development objective. The substantive terms of IIAs must be interpreted to advance the purposes of treaties in which they are contained. From the point of view of the state, the expected outcome of an investment is the development of the host state because that expected outcome is one of the reasons the states entered into the IIA at the minimum as textually revealed in preambles. Thus, while a business transaction might ordinarily and normally qualify as an investment without the presence of and need for the expected outcome, for purposes of and within the context of an IIA such a business transaction does not qualify as an investment if the expected outcome cannot be realised or is not present. In such a situation, the state’s obligation to protect which was undertaken because of that expected outcome should not be enforceable against the state. Furthermore, even if it does not qualify and is not treated as a constituent element of the concept of investment, an investment should not be entitled to protection to the extent that that contribution to development is clearly stated as an objective of the applicable IIA and it is manifest that the IIA was entered into for that the realisation of that objective besides any others that may be ascertainable from the IIA.

#### *B. Contribution to Development as an Essential Element of Investment*

There are other cases that hold the contrary view that the contribution of an investment to the development is an element of the concept of investment and should be taken into consideration in making decision whether such an investment is entitled to legal protection under the applicable treaty. A case in point is *Fedax NV v Republic of Venezuela*<sup>66</sup> in which Fedax alleged that Venezuela did not pay the principal sum owing under six promissory notes it had purchased as investment, regular interest on five of such promissory notes, and penal interest from the dates of maturity on all six promissory notes. The claim was brought under an investment treaty between the Kingdom of the Netherlands and the Republic of Venezuela which guaranteed investments fair and equitable treatment; no impairment, arbitrary or discriminatory treatment; full physical protection and treatment; and national treatment.<sup>67</sup> Venezuela argued there was no investment because there was no contribution to the country’s development. The Tribunal stated that for a project undertaken by an investor to qualify as an investment, “it must be for a certain duration, a certain

<sup>63</sup> Ibid., at [5.43].

<sup>64</sup> *Saba Fakes v Turkey*, ICSID Case No. ARB/07/20, at 97 (emphasis added).

<sup>65</sup> Ibid., at [97].

<sup>66</sup> *Fedax NV v Republic of Venezuela*, ICSID Case No ARB/96/3, Decision of the Tribunal on Objection to Jurisdiction (11 July 1997).

<sup>67</sup> *Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela* entered into force 1 November 1993 art 3.

regularity of profit and return, an assumption of risk, a substantial commitment made by the investor and the project must be significant for the host state's development."<sup>68</sup> The Tribunal held that the transaction was an investment because it met the criteria of investment that required "a significant relationship between the transaction and the development of the host State."<sup>69</sup> However, the Tribunal did not establish that the promissory notes actually contributed to Venezuela's development. This suggests that Tribunals might just make whimsical or conclusory statements about the *significance* of a business project's contribution to development in defining investment for the purposes of establishing their jurisdiction in the particular case without proving in specific terms how the alleged investment has really contributed to development.

In *Salini Costruttori SpA & Italstrade SpA v. Morocco*,<sup>70</sup> the Tribunal considered whether a public works contract constituted an investment and thus gave rise to its jurisdiction. The Tribunal held that in light of the preamble to the ICSID Convention, "one may add the contribution to the economic development of the host state to the investment as an additional condition"<sup>71</sup> to the elements required for a transaction to qualify as an investment such as the duration of performance of the contract and participation in the risks of the transaction.<sup>72</sup> The Tribunal concluded that since the contracts involved an infrastructure project, its contribution to the economic development of the Moroccan State could not be questioned because the highway project was going to serve the public interest and moreover the companies involved were going to provide Morocco with know-how in relation to the work to be accomplished.<sup>73</sup> Again, in *Patrick Mitchell v Democratic Republic of the Congo* it was stated that:<sup>74</sup>

the existence of a contribution to the economic development of the host State as an essential — although not sufficient — characteristic or unquestionable criterion of the investment, *does not mean that this contribution must always be sizable or successful*; and, of course, *ICSID tribunals do not have to evaluate the real contribution of the operation in question. It suffices for the operation to contribute in one way or another to the economic development of the host State*, and this concept of economic development is, in any event, extremely broad but also variable depending on the case.

*Patrick Mitchell v The Democratic Republic of Congo*,<sup>75</sup> *Malaysian Historical Salvors SDN BHD v The Government of Malaysia*,<sup>76</sup> *Alex Genin Eastern Credit Ltd Inc v The Republic of Estonia*,<sup>77</sup> *Pantechniki S.A. Contractors & Engineers (Greece) v. The Republic of Albania*,<sup>78</sup> *Amoco Asia Corporation v Republic of Indonesia*<sup>79</sup> and *Joseph Charles Lemire v Ukraine*<sup>80</sup> also recognized contribution to the economic

<sup>68</sup> *Fedax v Venezuela*, See above note 66, at [43].

<sup>69</sup> *Ibid.*

<sup>70</sup> *Salini Costruttori SpA & Italstrade SpA v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001).

<sup>71</sup> *Ibid.*, at [52].

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*, at [57].

<sup>74</sup> *Patrick Mitchell v The Democratic Republic of Congo*, Case No. ARB/99/7, Decision on the Application for Annulment of the Award, 1 November 2006, at [33] (emphasis added). Among the cases *Malaysian Historical Salvors Sdn, BHD v. Malaysia*, ICSID Case No. ARB/05/10, Award on Jurisdiction, 17 May 2007, at [143] seem to have made a bold departure by holding that there was the need for a transaction to make substantial contribution to the host country's development to qualify as an investment. This decision was subsequently annulled *Malaysian Historical Salvors Sdn, BHD v. Malaysia*, ICSID Case No ARB/05/10, Decision on an Application for Annulment paras. 61 and 80 (16 April 2009).

<sup>75</sup> *Patrick Mitchell v The Democratic Republic of Congo*, Case No. ARB/99/7, Decision on the Application for Annulment of the Award, 1 November 2006, paras. [27-41].

<sup>76</sup> *Malaysian Historical Salvors SDN BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Award, 17 May 2007. However, *Malaysian Historical Salvors SDN BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, 16 April 2009, paras. [56-61] found the same contract to be an investment without reference to the need for contribution to development.

<sup>77</sup> *Alex Genin Eastern Credit Ltd Inc v The Republic of Estonia*, Case No. ARB/99/2, Award, 25 June 2001, at [348].

<sup>78</sup> *Pantechniki S.A. Contractors & Engineers (Greece) v. The Republic of Albania*, ICSID Case No ARB/07/21, Award, 30 July 2009, at [81-82].

<sup>79</sup> *Amoco Asia Corporation v Republic of Indonesia*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 25 September 1983, at [23].

<sup>80</sup> *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability,



development of the host country as a characteristic of investment for the purpose of deciding if an investment is entitled to protection.

In effect, some of foregoing cases are authorities for the legal proposition that contribution to a host country's development is not a mandatory element for the concept of investment and that the legal obligation to protect an investment may subsist even if an investment does not make contribution to development. Therefore, tribunals are not under any obligation to make a finding that a particular investment has to contribute to a host country's development. It is sufficient for the purpose of determining whether a transaction constitutes an investment and is entitled to investment treaty protection if the transaction is important, significant or has the potential to contribute to the host country's development. A finding that a transaction has actually contributed to a country's development is not relevant in determining whether the transaction constitutes an investment. Such an approach raises the question as to what the consideration or *quid pro quo* is for states in return for the legal protections they have to accord foreign investors. This is important to consider given that the legal obligation to protect foreign investment may lead to state liability to pay damages to the investor for breach of the legal protection.

Most, if not all, investment treaties, specify their purposes in their preambles. Yet, *Société Générale*<sup>81</sup> suggests that the goals or purposes of IIAs are of less interpretive importance than the actual terms of the IIAs when it comes to enforcing the rights of the parties to the IIAs. This means that the development objective of IIAs must be subordinated to the interest of the investor to make profits, which is not textually revealed in IIAs. Such an approach delinks the legal obligation to protect an investment from a fundamental *reason states* assume that treaty obligation to protect the investment. It follows, as stated in *Malaysian Historical Salvors v Malaysia*, that "a purely commercial entity, intended only for the enrichment of its owners and not connected with the economic development of the host State, is entitled to bring before ICSID a dispute concerning an investment in the host State."<sup>82</sup> In effect, some investment tribunals have completely and effectively minimised the relevance of development in international investment law and arbitration. The above cases and others challenging measures adopted by Argentina in response to economic and financial crisis<sup>83</sup> suggest that investment protection by treaty may, in some cases, come to stand in the way of development rather than promoting it.

#### IV. Centralising Contribution to Development in Investment Treaty Interpretation

The objective of development is embedded in the investment treaty regime's preambles thereby making an investment's contribution to development a constituent, and I argue, essential and necessary element of an investment. That development objective must inform the interpretation and enforcement of the substantive terms of investment treaties. From a textual perspective, unless the preamble or provision of an investment treaty shows in clear and unambiguous terms that its primary and sole purpose is the protection of foreign investment as an end, it will be out of context of the treaty to interpret it in disregard of its development implications if the treaty's preamble or provision states that it is aimed at attracting foreign investment for development. The issue here is not whether preambles prevail over substantive provisions in law but whether preambles contain purposes that the substantive terms of investment treaties must be interpreted to advance. This distinction is often not made in the literature.<sup>84</sup> Such a distinction is important because it allows for the existence of a treaty's objective in its preamble to be recognized and admitted, and the substantive terms interpreted in light of that objective. A failure to make the distinction is partly responsible for dismissive attitude of tribunals towards preambles and the concomitant expansive

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14 January 2010 paras. [272-273].

<sup>81</sup> *Société Générale v Dominican Republic*, See above note 44.

<sup>82</sup> *Malaysian Historical Salvors Sdn, BHD v Malaysia*, ICSID Case No ARB/05/10, Decision on an Application for Annulment, 6 April 2009, Dissenting Opinion of Judge Mohamed Shahabuddeen at [21]

<sup>83</sup> *Continental Casualty Company v. Argentina*, ICSID Case No ARB/03/9, Award, 5 September 2008; *LG & E Energy Corporation v Argentina*, Decision on Liability, ICSID Case No ARB 02/1, 3 October 2006; *Enron Corporation v Argentina* ICSID Case No. ARB/01/3, Award, 22 May 2007.

<sup>84</sup> Dagbanja Investment Treaties and Development Policy, See note 4 above, p. 453.

and unqualified interpretation of the substantives of IIA in order to provide absolute protection for the investor.

The imperative to interpret investment treaties in accordance with the objectives contained in their preambles, and not just in terms of their substantive standards of investment of protection, is consistent with Article 31(1) and (2) of the Vienna Convention of the Law of Treaties, wherein it is stated:

A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes.

In his seminal book, *Bennion on Statutory Interpretation*, Francis Bennion defined purposive construction or interpretation as “one which gives effect to the legislative purpose.”<sup>85</sup> From this purposive and contextual approach to treaty interpretation<sup>86</sup>, the concept of investment has to be interpreted in the context in which those terms are used and in light of the object and purpose of that treaty unless the definition of the concept in the IIA expressly excludes certain elements. The context of a treaty includes its preamble and substantive terms. Therefore, so long as textually the attraction of investment *for the attainment of development* is stated as an objective of and reason for bringing the particular investment treaty into being, a business activity or transaction can only constitute an investment if it will make such contribution to the development of the host state, although in a different other context it might constitute an investment without having to make any form of contribution. This appears to be the position taken by the Tribunal in *Saluka Investments v Czech Republic*,<sup>87</sup> which discerned the purpose of the agreement from its title and preamble<sup>88</sup> as recognizing that an agreement “upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment is desirable” to that effect. In interpreting these provisions, the Tribunal stated that:<sup>89</sup>

This is a more subtle and balanced statement of the Treaty’s aims than is sometimes appreciated. The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties’ economic relations. That in turn calls for a balanced approach to the interpretation of the Treaty’s substantive provisions for the protection of investments, since an interpretation which exaggerates the protection to be accorded to foreign investments may serve to dissuade host States from admitting foreign investments and so undermine the overall aim of extending and intensifying the parties’ mutual economic relations.

The challenge is how to define what contribution to the development of the host state. It might be argued that the concept of ‘development’ is amorphous and very broad since it can contain many elements. This situation can make it difficult for investment tribunals to define and measure development and the contribution of an investment to the development of the host state. *Salini Costruttori SpA & Italstrade SpA v. Morocco*<sup>90</sup> said so. However, investment promotion and protection by treaty is premised on the

<sup>85</sup> Francis Bennion, *Bennion on Statutory Interpretation: A Code* (5edn, LexisNexis, 2008) at 944. See also *Fothergill v Monarch Airlines Ltd* [1981] AC 151 at 272; and *Sweet v Parsley* [1970] AC 132 at 165.

<sup>86</sup> Readings on treaties and their interpretation include: Richard K Gardiner, *Treaty Interpretation* (2edn, Oxford University Press, 2015); Anthony Aust, *Modern Treaty Law and Practice* (Cambridge University Press, 2007); Arnold D. McNair, *The Law of Treaties* (Clarendon, 1986); Ian Sinclair, *The Vienna Convention on the Law of Treaties*. 2edn, Manchester University Press, 1984); Maarten Bos, ‘Theory and Practice of Treaty Interpretation’ (1980a) 27(1) *Netherlands International Law Review* 3; and Maarten Bos, ‘Theory and Practice of Treaty Interpretation’ (1980b) 27(1) *Netherlands International Law Review* 135.

<sup>87</sup> *Saluka Investments BV (The Netherlands) v Czech Republic*, Partial Award, 17 March 2006.

<sup>88</sup> *Ibid.*, [299].

<sup>89</sup> *Ibid.*, [300].

<sup>90</sup> *Salini Costruttori SpA & Italstrade SpA v. Morocco*, See note 70 above.

conventional wisdom that it creates jobs, raises productivity and enhances exports and leads to transfer technology.<sup>91</sup> According to those who support investment protection by treaty, inward investment offers an additional avenue for developing countries to link up to global markets and production systems. These investments could help firms to access markets, natural resources, foreign capital, technology, or various intangible assets that are essential to their competitiveness that may not be readily available in their home countries.<sup>92</sup> In summary, these include the stated benefits of the legal commitment to protect foreign investment. These stated benefits can form the starting point for a tribunal with the aid of counsel to determine whether the investment at stake has made or can make contribution to the host state's development. If a state alleges that an investment has made no contribution to its development or could not have been expected to have made any contribution to its development at the time of the admission of the investment and not entitled to protection, the burden is on the state to prove its case.<sup>93</sup> That the concept of development is difficult to define is no excuse for a tribunal to refuse to make a determination whether an investment has made a contribution to the development of the host state. For as state in Article 42(2) of the ICSID Convention a tribunal "may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law" (whether IIA or other source of law).

Thus, in making an assessment of an investment's contribution to the development of the host state, account should be taken of what foreign investment is said to be capable of bringing to the host state, namely, transfer technology or know-how to the host state, employment, enhancement of the Gross Domestic Product of the host country, and the overall impact of the investment on the host state's development.<sup>94</sup> I adopt the perspective advanced by Dr Omar García-Bolívar, that:<sup>95</sup>

If an investment is contrary to the public interest, has not generated any knowledge transfer to the host State, has not enhanced the economy or its productivity, has not increased the standards of living of the host country or the labour conditions, it almost certainly has not made a contribution to the economic development of that country... [T]hat investment should be denied protection.

In particular, the ICSID arbitral system which was established to resolve investment disputes must resolve those disputes taking into consideration the overall objectives of its applicable convention, which objectives are not limited to promoting profiting making alone.<sup>96</sup> For the contracting parties to ICSID Convention, international cooperation was seen as needed for economic development. Development cooperation is enhanced by private international investment. The substantive obligations states assume to promote and protect foreign investment are aimed at attaining that development. So it would be hard to convincingly argue that this Convention is aimed at investment protection as an end itself and that development is completely irrelevant in its scheme of things.

Furthermore, where a treaty incorporates sustainable development and public interests objectives into its terms, tribunals must respect and uphold those objectives just as they would do in the case of those aimed at protecting private property interests. For example, an investment and trade agreement such as the TPPA substantively recognizes and guarantees the right of states parties to regulate in the public interest such protecting the environment and health which must be taken into consideration in interpreting it. Article 9.16 of the investment chapter states:

Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that

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<sup>91</sup> Annan, See note 16 above.

<sup>92</sup> Ibid.

<sup>93</sup> Rahim Moloo, 'Evidentiary Issues Arising in an Investment Arbitration' in Chiara Giorgetti (ed), *Litigating International Investment Disputes: A Practitioner's Guide* (Brill Nijhoff 2014) 287.

<sup>94</sup> Omar E García-Bolívar, 'Economic development at the core of the International Investment Regime' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) 586, p. 603.

<sup>95</sup> Ibid., p. 595.

<sup>96</sup> See Christoph H. Schreuer, *The ICSID Convention: A Commentary* (2edn, Cambridge University Press, 2009).

investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.

Apart from textual considerations, it can also be argued from a contract law perspective, that legal obligation to protect an investment is an *offer*<sup>97</sup> in return for the benefit that the state expects to receive from the investment made by the investor. If an investor knowing very well that investment treaty was intended to attract the investment to enhance the development of the host country proceeds to make the investment, then it expressly or impliedly and necessarily agrees that the investment it will make will contribute to the development of the host state. In such case the investor can only enjoy legal protection under the investment treaty if its investment will contribute to the development of the host state. The benefit or expected outcome of the investment to the host state, not the investment itself, is the *consideration* for the *offer* to protect made by the state.<sup>98</sup> Thus, investment treaty law and arbitration cannot be sustained in such a case if its practical implementation is lopsided, where it focuses solely on the *offer* by imposing damages or penalties on the state for failing to fulfil the legal obligation to protect without considering whether the investor has fulfilled its part of the bargain by making an investment that brings benefits to the host state.<sup>99</sup>

The benefits, consideration, could be in the form of technology and know-how, employment of local people, provision of goods and services that serve the national interest and other benefits. The benefits of an investment could also be assessed in terms of the impact of the investment on the environment and natural resources (including quality of water) and labour rights of the local people.<sup>100</sup> If an investment impacts negatively on the environment and natural resources in a manner that neutralizes any other benefits it brings, the rights available for the investor should correspondingly be reassessed and re-evaluated. These matters are important and should be regarded in investor-state disputes settlement. There is the need for *sustainable investment disputes settlement*. *Sustainable investment disputes settlement* arises where the interests of both the investor and the state under the applicable investment treaty are treated as mutually supportive of the continued existence and relevance of the very treaty regime that establishes the respective rights and interests and its disputes settlement mechanisms.<sup>101</sup>

In summary, the following premises underlie this article:

1. One of the reasons states (at least developing countries) enter into IIAs is to attract investment that will contribute to their development and not necessarily to attract and protect foreign investment as ends in and of themselves.
2. Treaties, including IIAs, are to be interpreted in context and in light of their object and purpose.
3. Unless expressly excluded as not being a constituent element of the concept of investment in IIA, contribution to development should be treated as essential element of investment to the extent that an IIA stipulates it as an objective for the making and coming into being of the IIA.
4. Given that IIAs are to be interpreted in light of their object and purpose, even if not capable of being treated as an essential element of investment the resolution of the issue whether or not an investment should be entitled to protection for want of contribution to the development of the host state should be dependent on whether such contribution can manifestly be said to be an objective of the IIA.

<sup>97</sup> See Richard Craswell, "Offer, Acceptance and Efficient Reliance" (1996) 48 *Stanford Law Review* 481

<sup>98</sup> See J. Cumberbatch, "Of Bargains, Gifts and Extortion: An Essay on the Function of Consideration in the Law of Contract" (1990) 19(3) 19 *Anglo-American Law Review* 239; K O Shatwell, "*The Doctrine of Consideration in the Modern Law*" (1953-4) 1 *Sydney Law Review* 789; John Swan, "Consideration and the Reasons for Enforcing contracts" (1976) 15 *University of Western Ontario Law Review* 83.

<sup>99</sup> Stephan W. Schill, *Reforming Investor-State Dispute Settlement (ISDS): Conceptual Framework and Options for the Way Forward* (International Centre for Trade and Sustainable Development, July 2015), <<http://e15initiative.org/wp-content/uploads/2015/07/E15-Investment-Schill-FINAL.pdf>> at 4 and 6

<sup>100</sup> Sornarah, Resistance and Change, See above note 3, p.163.

<sup>101</sup> See *Report of the World Commission on Environment and Development: Our Common Future* (1987) available at <http://www.un-documents.net/wced-ocf.htm>.

5. If an investment's contribution to development is an essential element of the concept of investment or is an objective of an IIA, the investment should not be entitled to protection under the IIA if it does not make such contribution.
6. Where an IIA has competing objectives, investment tribunals must resolve investment disputes *sustainably*. They must not be predisposed to make decisions in favour of one of the disputing parties or one of the competing interests. Investment tribunals must objectively take all the competing interests into consideration and make decisions in light of the facts and evidence. In this regard, as risk is an inherent part of investment, tribunals must not seek to protect investment against each and every risk, including risks *inherent* in justified regulation. The legitimate rights of investors must be protected without compromising the rights of states to regulate now or in future in to promote development.

## *V. Modernising International Investment Agreements to Promote Development*

The reason investment tribunals hold that an investment's contribution to development is not a constituent or essential element of an investment is substantive imbalance in the terms of IIAs. Whereas investment treaties impose substantive standards of investment protection on states, similar obligations are not imposed on investors. The reason for such lack of corresponding obligations appears to be the orthodox view that foreign investment leads to development and everything must be done to secure protection for the investor.

In this regard, there is the need to modernise the IIA regime in at least four aspects. First of all, there is the need to be explicit in the substantive terms of IIAs about the role that investment activity must play to the development of the host state if such investment is to enjoy legal protection under the applicable IIA. While recent IIAs (such as TPPA Articles 9.8 and 9.16) tend to make exceptions for public interest regulation such as environmental protection, labour rights and limiting the scope of expropriation standard, those exceptions are commonly qualified in terms that limit their potency to practically give states the scope they need to regulate in the public interest. Thus, the contribution of an investment to development must be stated as a positive obligation that investors must observe. Investors must have an express obligation to ensure that their investment operations contribute to the development of the host state.

Secondly, the concept of investment must be defined in IIAs in terms that expressly include contribution to development as a constituent element. This will remove doubt as to the status of this criterion in identifying the elements of an investment.

Thirdly, there is the need for specific indices of what constitutes contribution of an investment to development to be contained in schedules to IIAs or to be developed as separate guidelines. Those indices will serve as a reference point for a tribunal that is faced with an argument that an investment is not entitled to protection for want of contribution to development.

Fourthly, the objectives of IIAs need to be stated in clearer and precise terms. The IIAs cannot replace rules of international law on international and diplomatic relations and cooperation. So they must just deal with the business and the specific state interests they seek to promote and nothing more. Thus if their objectives are to secure legal protection for investments to guarantee investor profits and returns in return for the contribution the investments will make to the development of the host state that must be precisely and unambiguously stated as their objectives. The terms of the IIA must mandate tribunals to interpret the IIAs to advance these objectives.

## *VI. Conclusion*

In theory and in practice states enter into investment treaties to promote their investment and not just to protect investment as an end in itself. This is very well settled and is empirically reflected in the preambles to investment treaties, and most recently in their substantive terms as contained in chapter 9 of

TPPA. In light of the fact that states conclude investment treaties to protect foreign investment in order *to promote their development* by ensuring that foreign investors are protected from non-commercial risks associated with regulation in particular.<sup>102</sup>

[I]t becomes important that to consider in the interpretation of IIAs the intention of the States when entering into those agreements. In some cases, that interpretation is relatively straightforward as the IIA itself identifies the intentions of the State Parties, and sets out the object and purpose of the agreement. But in other instances, the States' intentions are not expressly stated. Where this is the case, it is suggested that the approach adopted by the arbitrators should be one of looking at all the surrounding circumstances, not only at the preamble and preparatory work, but also at the *raison d'être* of the States themselves as well as the reasons for entering into the agreement — in other words the promotion of the welfare and development of communities within the host State.

The development objective can no longer be treated as peripheral in investor-state dispute settlement: it is a central part of the investment treaty regime and must be treated as such. The investment treaty regime as reflected in recent backlash against the regime<sup>103</sup> cannot be sustained unless competing objectives under the regime are all adequately respected and upheld. This means there is the need for a *sustainable investment disputes settlement* approach to handling investment disputes: development is and must be treated as necessary for the attainment of the objective to provide a secure environment investment under the applicable investment treaty. The objective to provide a secure legal environment for investment to flourish and gain profits must be pursued in a manner that does not compromise the overall development objective for which a state has undertaken the obligation to protect the investment. The development objective should prevail over the need to guarantee an investment secure protection and vice versa depending on the facts and circumstances of the case. It cannot be that the investor's interests must always have its way and at all cost as has been the case. The statement of development an objective of investment treaties should also condition the nature and scope of the investors' responsibility in terms of ensuring that their investments contribute to the development of the host state. This is the only way a balance of rights and corresponding obligations between investors and their host states can be attained.<sup>104</sup>

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<sup>102</sup> García-Bolívar, See above note 94, 588 and 589-590.

<sup>103</sup> Michael Waibel et al (eds), *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International, 2010); Suzanne A Spears, "Making Way for the Public Interest in International Investment Agreements" in Chester Brown and Kate Miles (eds) *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press, Cambridge 2011) 271 Suzanne A Spears, "The Quest for Policy Space in a New Generation of International Investment Agreements" (2005) 13(4), *Journal of International Economic Law* 1037; and Asha Kaushal, "Revisiting History: How the Past Matters for the Present Backlash against the Foreign Investment Regime" (2009) 50 *Harvard International Law Journal* 491.

<sup>104</sup> *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID CASE NO. ARB/05/22, Award. 24 July 2008, at [380].

## *UNCITRAL and the Possibility of Returning to the Multilateral Regulation of Foreign Investments*

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In the historical development of the international investment framework, there have been some multilateral attempts to regulate foreign investments. From the 1950s to the 1970s the United Nations (UN), was the first multilateral forum used to regulate foreign investments. It was a platform for countries to reach decisions about the rules by consensus. As a result, there were numerous UN General Assembly resolutions concerning rules of foreign investment. UN General Assembly resolutions have the legal value of being *de lege ferenda*, meaning that states should strive to practice in accordance with what the resolutions recommend, they are, however, not binding. In matters pertaining to the establishment of an international investment framework, countries instead engaged in bilateral negotiations, in attempts to agree on different rules. Most countries signed Bilateral Investment Treaties (BITs), which contained different provisions than the ones contained in the UN resolutions. Most of these treaties were signed in the 1990s, though the signings did not end then. On the other hand, the World Trade Organization (WTO), once established, was also used as a multilateral forum to bring about regulation of investment rules. Investment regulations were proposed at the 1996, 1999, 2001 and the 2003 WTO Ministerial conferences. In a similar vein to what had occurred at the UN, however, the agreements were not reached at the multilateral level and more investment treaties continued to be signed at a bilateral level.<sup>1</sup> As a result, the current framework was formed, for the most part, bilaterally. However, some current developments, in which the work of UNCITRAL played a crucial role, suggest yet again a return to the multilateral level to amend the current international framework. The question is, then, why are countries returning to the multilateral forum to amend or improve the existing rules?

In this paper, I will argue that criticisms against the bilaterally established international investment framework have once again prompted actors to return to a discussion of foreign investment rules at the multilateral level. This results in a forum shifting that can be explained by international relations theories relating to modified structural approaches and contested multilateralism.

Since the criticism arise mainly from the enforcement of investor-state dispute settlement clauses in investment treaties, in the first section, I shall discuss the different arbitration institutions and rules in investor-state dispute settlement clauses. In the second section, I shall discuss how the inclusion of transparency provisions in investor-state disputes settlement has opened up the possibility for returning to a multilateral forum for amending or improving the foreign investment rules. In the third and last section, I shall explain this phenomenon of forum shifting, from the bilateral to the multilateral, by using the theoretical lenses of modified structural approaches and contested multilateralism.

### *1. International Arbitration Rules in Investor-State Disputes.*

For settling investor-state disputes, most International Investment Agreements (IIAs) feature international arbitration as a mechanism to settle such disputes. One of the main international arbitration institutions for settling investor-state disputes has been the International Centre for the Settlement of Investment Disputes (ICSID). ICSID was established in 1965 with the “Convention on the Settlement of Investment Disputes between States and Nationals of Other States” (the ICSID Convention), and it is one of the five agencies of the World Bank. ICSID is a specialized institution created for the sole purpose of settling investment disputes.<sup>2</sup>

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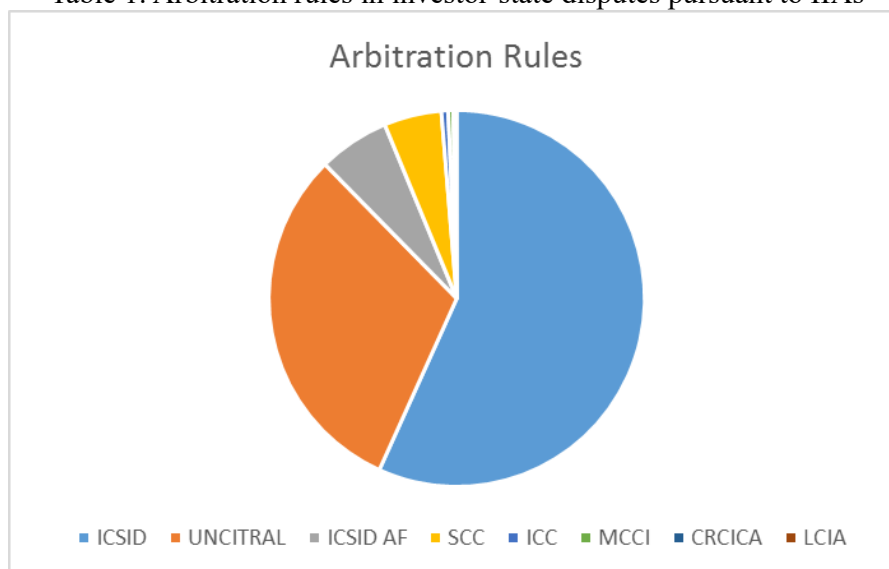
\* I would like to thank the Oxford-Princeton Global Leaders Fellowship Programme for funding this research, and Robert O. Keohane for reading a previous version of this paper and giving very helpful comments.

<sup>1</sup> Gwynn, M.A. *Power in the International Investment Framework* Palgrave Macmillan. 2016. Chapter 3 and 6.

<sup>2</sup> See the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, Introduction; Parra, A. *The History of ICSID* Oxford University Press. 2012; Schreuer, C., Malintoppi, L., Reinisch A, Sinclair, A. ‘The ICSID Convention: A Commentary’ 2<sup>nd</sup> Ed. Cambridge University Press. 2009.

As of January 2017, the investor-state dispute settlement mechanism of IIAs has been used in 756 cases.<sup>3</sup> The disputes have been mainly submitted to ICSID, and thus the ICSID rules for arbitration were used. However, the data also shows that ICSID is followed by a great number of investor-state disputes that have been submitted for international arbitration in which the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules are used.<sup>4</sup> (See Table 1)

Table 1. Arbitration rules in investor-state disputes pursuant to IIAs



Source: UNCTAD, Applicable Arbitration Rules.

The United Nations Commission on International Trade Law (UNCITRAL) was established in 1966 by United Nations Resolution No. 2205. Its mandate was “to further the progressive harmonization and unification of the law of international trade”.<sup>5</sup> The Commission was charged to do this by, *inter alia*, “establishing and maintaining a close collaboration with the United Nations Conference on Trade and Development.”<sup>6</sup> The resolution also stated that the Commission shall “bear in mind the interests of all peoples, and particularly those of developing countries, in the extensive development of international trade.”<sup>7</sup> The UNCITRAL Arbitration Rules were adopted in 1976, but these rules were mainly created for commercial arbitration.

In IIAs, once a dispute arises, the dispute settlement clause will establish the dispute settlement mechanism to be followed. In some treaties the parties are given a choice of which arbitration rules to use.

<sup>3</sup> UNCTAD World Investment Report 2016 reported 696 cases as of January 2016. This number has increased to 756 in 2017 for known cases that have used arbitral rules. The number is higher if the cases with no data available are considered. UNCTAD Investment Policy Hub.

<sup>4</sup> In the total of investor-state disputes cases, 390 are ICSID cases, 212 UNCITRAL, 85 other rules, 9 unknown. The other rules include those of CRCICA (Cairo Regional Center for International Commercial Arbitration), ICC (International Chamber of Commerce), ICSID (International Centre for Settlement of Investment Disputes), ICSID AF (ICSID Additional Facility), LCIA (London Court of International Arbitration), MCCI (Moscow Chamber of Commerce and Industry), PCA (Permanent Court of Arbitration), SCC (Stockholm Chamber of Commerce). See UNCTAD Investment Dispute Settlement database.

<sup>5</sup> UN Resolution 2205(XXI) of 17 December 1966; See also “Origin, Mandate and Composition of UNCITRAL”, available at [http://www.uncitral.org/uncitral/en/about\\_us.html](http://www.uncitral.org/uncitral/en/about_us.html).

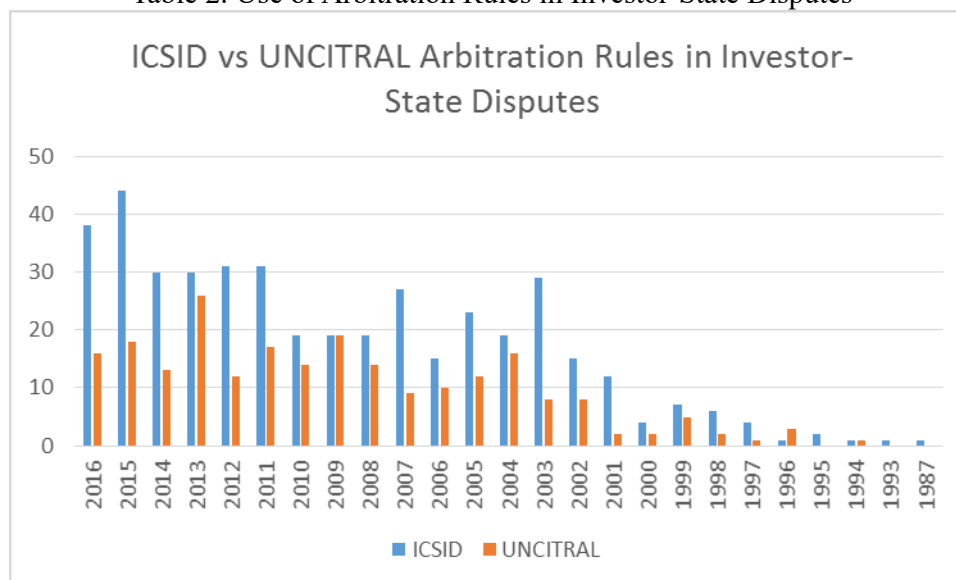
<sup>6</sup> UN Resolution 2205(XXI) of 17 December 1966; See also “Origin, Mandate and Composition of UNCITRAL”, available at [http://www.uncitral.org/uncitral/en/about\\_us.html](http://www.uncitral.org/uncitral/en/about_us.html); The first attempt to regulate investment at a multilateral level was at the UN. Developing countries were questioning the Bretton Woods system because they claimed it benefited only those who created them. Due to such an uprising of developing countries’ demands, the United Nations Commission for Trade and Development (UNCTAD) was created in 1964 to support developing countries. See Gwynn, M.A. *Power in the International Investment Framework* Chapter 2. Palgrave Macmillan. 2016.

<sup>7</sup> UN Resolution 2205(XXI) of 17 December 1966; See also “Origin, Mandate and Composition of UNCITRAL”, available at [http://www.uncitral.org/uncitral/en/about\\_us.html](http://www.uncitral.org/uncitral/en/about_us.html).



States that have ratified the ICSID Convention automatically give consent to its jurisdiction; but if the treaties allow, the parties can consent to submit the dispute to international arbitration using the UNCITRAL rules instead.<sup>8</sup> ICSID is still used more, but it is interesting to note that although UNCITRAL Arbitration Rules were not created for the sole purpose of settling investment disputes, and yet over the years, their general use in *investor-state* disputes substantially increased. (See Table 2)

Table 2. Use of Arbitration Rules in Investor-State Disputes



One explanation for the use of UNCITRAL arbitration rules in investor-state disputes is the attractive flexibility that the rules give to the parties for conducting arbitration.<sup>9</sup> The UNCITRAL Arbitration rules are like guidelines for the parties, who, for example, can freely choose the place of arbitration and can even modify the rules if both parties agree. In contrast, ICSID arbitration rules, being institutional rules, are more rigid in those regards.

However, although the latter might be the colloquial explanation for the increased use of UNCITRAL rules in investor-state disputes, there is room for considering another view. I shall argue that the increase of the use of UNCITRAL rules in investor-state disputes might be connected to the institutional response to the criticisms regarding the enforcement of the IIAs rules. Parties' perception on how effective the institutional response to such criticism is affects their preference over the use of the particular institutions' rules. To illustrate this point, I will discuss the response regarding demands for transparency in investor-state disputes.

<sup>8</sup> In investor-states disputes, the United States, for example, has had 16 investment disputes up to February 2017 and the UNCITRAL Arbitration Rules have been used in 11 of these disputes. In South America, Bolivia, Ecuador and Venezuela have terminated the ICSID Convention, so since 2010, disputes against Bolivia and Ecuador have used the UNCITRAL Arbitration Rules, but against Venezuela the ICSID rules continued to be used. Though it might seem that this situation is due to the termination of the ICSID Convention and some of their BITs, the sunset clauses mean that the provisions will stay in force for many years after the termination of the treaty. As the Venezuela case shows, even after it terminated the ICSID Convention, cases are still submitted there. In general, the data show the percentage increase of the use of UNCITRAL rules in certain years. See also UNCTAD Press Release 'Number of international investment disputes mushroomed in 2012'. Figure 2. UNCTAD/PRESS/PR/2013/007 Geneva, Switzerland, (10 April 2013). Available at <http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=120> Accessed July 24 2016.

<sup>9</sup> See Franchini, J. 'International Arbitration Under UNCITRAL Arbitration Rules: A Contractual Provision for Improvement' Fordham Law Review. Vol 62. 1994; Caron, D and Caplan, L *The UNCITRAL Arbitration Rules: A Commentary* Oxford University Press. 2013.

## 2. Increased Transparency Rules in Investor-State Disputes and the Role of UNCITRAL

Some disputes submitted by foreign investors against a host state to international arbitration were due to the regulations of the host state. In some cases, arbitral awards settling those cases had the consequence of restricting the host state's ability to regulate. For this reason, respondent states started to criticize the international investment framework for allowing this.<sup>10</sup> As the awareness of the public interest in these disputes grew, many NGOs likewise complained, alongside some bodies of the European Union. These actors also became aware of their alienation from such controversies.<sup>11</sup>

Arbitrations conducted at ICSID used to only allow for public notices of the disputes and permitted the parties to publish the awards upon their initiative. As a consequence of the criticism, ICSID addressed the concerns about lack of transparency and modified its arbitration rules in 2006. Since then, it made its hearings public and allowed for the possibility of submitting amicus curiae reports.<sup>12</sup> Every other stage of the process, however, remained confidential. The limited scope of these amendments may have been the reason that actors within the framework began to seek actions from the other relevant forum in investor-state disputes.

In 2007, UNCITRAL's Working Group on Arbitration and Conciliation noted that further work on the UNCITRAL Arbitration Rules should take into account investor-state arbitration.<sup>13</sup> Urging for the need to enhance transparency in investor arbitrations, in April 2008 the Office of the United Nations High Commissioner for Human Rights issued a statement, declaring that 'where human rights and other public interests are concerned, transparency should be a governing principle...'.<sup>14</sup> Only two months later, in June 2008, Canada requested UNCITRAL to give the Working Group a mandate to improve the institution's functionality in that area. It was mentioned in the request that "failing to promptly include, at the earliest possible opportunity, provisions allowing for enhanced transparency will give the impression that the United Nations approves of a lack of transparency in investor-state arbitration. Such an effective endorsement of secrecy in investor-state arbitration would be contrary to the fundamental principles of good governance and human rights upon which the United Nations is founded."<sup>15</sup> In this timeframe, 2007-2009, the use of UNCITRAL rules in investor-state disputes increased considerably (See Table 2). The fact that after those years it decreased again can be explained by the many cases against Venezuela whose BITs do not include UNCITRAL as a choice in the dispute settlement clause,<sup>16</sup> or for the number of cases deriving

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<sup>10</sup> For example, Argentina complained strongly after the cases regarding their financial regulation during the financial crisis of 2001. In 2008, Brazil gave a statement saying that it would not ratify BITs because of the cost to their sovereignty. Around the same time, Bolivia started terminating its BITs, and it also terminated the ICSID Convention in 2007. So did Ecuador; it terminated some of its BITs and the ICSID Convention in 2009. In 2012, Venezuela also terminated the ICSID Convention. In the same year, Argentina submitted a draft of law to the Congress to terminate the ICSID Convention. Both Australia, in 2011, and Uruguay, in 2014, made public statements complaining about the settlement mechanism of BITs after being sued for regulations in the area of public health; Gwynn, M.A. *Power in the International Investment Framework*. Chapter 6; See also Australia's Response to the Notice of Arbitration. 2011. Available at <https://www.ag.gov.au/Internationalrelations/InternationalLaw/Documents/Australias%20Response%20to%20the%20Notice%20of%20Arbitration%2021%20December%202011.pdf> Last accessed July 26, 2016.

<sup>11</sup> See for example the International Institute for Sustainable Development (IISD), <http://www.iisd.org/topic/investment> ; and Greenpeace Netherlands, <https://www.ttip-leaks.org/>. For statements of the European Parliament see European Parliament resolution of 6 April 2011 on the future European international investment policy (2010/2203(INI)).

<sup>12</sup> ICSID Arbitration Rules. Chapter IV. Rule 32 (2) and Rule 37 (2).

<sup>13</sup> Report of the United Nations Commission on International Trade Law on the work of its fortieth session, U.N. Doc. A/62/17 (Part I), at ¶ 175 (23 July 2007).

<sup>14</sup> Human Rights Council, Protect, Respect and Remedy: a Framework for Business and Human Rights: Advance Edited Version, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, U.N. Doc. A/HRC/8/5, at ¶ 37 (7 April 2008) available at <http://www2.ohchr.org/english/bodies/hrcouncil/docs/8session/A-HRC-8-5.doc>.

<sup>15</sup> United Nations Commission on International Trade Law forty first session, U.N. Doc. A/CN.9/662 (12 June 2008) p. 7.

<sup>16</sup> Gwynn, M.A. *Power in the International Investment Framework*. Chapter 4.

from the Energy Charter, in which, although UNCITRAL rules are a choice for the parties, it has the restriction of using them only with a sole arbitrator and not in an arbitration tribunal.<sup>17</sup>

The need for transparency in investor-state arbitrations continued to be pledged by other actors. In 2010, the European Union also contemplated transparency provisions as part of their international investment policy.<sup>18</sup>

The consensus on transparency in matters that concern public interest is almost universal; transparency in investor-state arbitrations has been no exception.<sup>19</sup> This is why the adoption of the UNCITRAL Rules on Transparency by the majority of countries was straightforward. In 2013, the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration were adopted by the UN General Assembly Resolution 68/109 and came into force on April 1, 2014. As compared to what ICSID had done to accommodate transparency provisions, the UNCITRAL Rules on Transparency are of a much broader scope because the rules allow for the whole arbitration process to be made public from the moment that the respondent state gets notified of the dispute.<sup>20</sup>

Since its adoption, every arbitration conducted henceforth under UNCITRAL Rules must observe the transparency regulations. The transparency rules also establish the creation of a repository, creating a registry of the disputes, all of which becomes available to the public. This information includes the names of the disputing parties, the economic sector involved, the treaty under which the claim is being made, the notice of arbitration, the response to the notice of arbitration, the statement of claim of defence and every other statement or written submission, the exhibits, expert and witness reports, non-disputing party submissions (*amicus curiae*), transcripts of hearings, orders, decisions and awards.<sup>21</sup>

However, the UNCITRAL rules on transparency contain an exception to the rules of transparency. This exception pertains to confidential or protected information, such as confidential business information, information that is protected from being made available to the public under the treaty or under the law of the respondent state or any law or rules determined by the arbitration tribunal, or when the disclosure is considered to be contrary to essential security interests of the state.<sup>22</sup> This exception will continue to please those who see the attractiveness of these rules in their flexibility because the parties can decide how to conduct the process and what to leave out as confidential.

The relevance of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration is that they are a key stone for the amendment of the framework rules. Their establishment was pursued by actors facing the challenge to overcome some of the criticism against the enforcement mechanism of the international investment framework.

Due to this, other developments at the multilateral level unfolded. The UNCITRAL Rules on Transparency entered into force in 2014, but most of the existing investment treaties are dated much earlier. Finding a way for the new UNCITRAL rules to have a retroactive effect was the next challenge. The problem was solved by using international law. The Vienna Convention on the Law of Treaties states that a later treaty can modify previous treaties if states agree to it.<sup>23</sup>

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<sup>17</sup> UNCTAD Investment Policy Hub. Investment disputes.

<sup>18</sup> Communication from the Commission to the Council, The European Parliament, The European Economic and Social Committee and the Committee of the Regions ‘Towards a comprehensive European international investment policy’ Brussels, 7 July 2010.

<sup>19</sup> See a contrary opinion in European Federation for Investment Law and Arbitration ‘A response to the criticism against ISDS’ May 2015. Accessible at [http://efila.org/wp-content/uploads/2015/05/EFILA\\_in\\_response\\_to\\_the\\_criticism\\_of\\_ISDS\\_final\\_draft.pdf](http://efila.org/wp-content/uploads/2015/05/EFILA_in_response_to_the_criticism_of_ISDS_final_draft.pdf).

<sup>20</sup> UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration.

<sup>21</sup> UNCITRAL Rules on Transparency, Article 2 and 3.

<sup>22</sup> UNCITRAL Rules on Transparency, Article 7.

<sup>23</sup> Vienna Convention on the Law of Treaties, Article 30: a successive treaty creating new obligations.

In December 2014, only 8 months after the UNCITRAL Rules on Transparency entered into force, the Mauritius Convention or United Nations Convention on Transparency in Treaty-based Investor-State Arbitration was adopted by UN General Assembly Resolution 69/116. The Mauritius convention provides for the transparency rules to be applied retroactively to all existing BITs. It will come into force when countries ratify it. So far, the convention has been signed by 17 countries; the first country to ratify it was Mauritius.<sup>24</sup> The United States Trade Representative Office has stated that “The United States is committed to ensuring the highest levels of transparency in all investor-state proceedings.”<sup>25</sup> The European Commission has also approved ‘pushing’ for transparency in investor state disputes by recommending the signing of the Mauritius Convention to the European Council.<sup>26</sup>

Although some scepticism might remain on whether the latter approach will work, as the toll for such a convention to come into force is each state’s ratification of the convention, the path pursued by the convention is relevant to the scholarship on the continuing development of the international investment framework. The Mauritius Convention was used as a meta-treaty to modify all previously-existing investment treaties so as to include transparency rules. This is the first step towards returning to multilateralism in the area of international investments.

The leap towards a consensual discussion of improving foreign investment rules at the multilateral level would be much greater if other criticized rules that exist in IIAs could also be amended in a way similar to the inclusion of the transparency rules in the framework.

And indeed, in May 2016, this exactly was proposed. The UNCITRAL Secretariat submitted to the Commission a proposition for further research to amend the topic of investor-state dispute settlement in a similar way as the transparency rules were adopted through the Mauritius Convention, i.e. to use the Mauritius Convention as a model for other conventions or as a complement to modify other rules. The proposition considers the establishment of a permanent dispute-settlement body to replace or complement investor-state provisions in existing and future treaties as well as the possibility of considering an appeal mechanism.<sup>27</sup>

Although the proposition limits itself to revising the investor-state dispute settlement, if accepted, this would nevertheless be a huge stepping stone towards the return to the multilateralization of investment rules. The Vienna Convention of the Law of Treaties allows for amending the existing investment treaties by successive treaties, as it was with the Mauritius Convention<sup>28</sup>, but the Vienna Convention also allows for the modification of existing treaties.<sup>29</sup> Either way, the final course of action to agree and to implement these conventions, will remain in the hands of each state. So the awareness of these developments is important, as well as the theoretical explanations of them that are discussed in the next section.

### 3. *Theoretical background for the Forum Shifting*

The efforts to include transparency provisions in the international investment framework at the multilateral level, the Mauritius Convention, and the proposition to further research other provisions of the investment framework, suggest a return to the multilateral level to amend the current international

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<sup>24</sup> Status United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (New York, 2014). [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/2014Transparency\\_Convention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency_Convention_status.html) Accessed November 25, 2016.

<sup>25</sup> The Facts on Investor-State Dispute Settlement. Official Blog of the United States Trade Representative. March. 2014. Available at <https://ustr.gov/about-us/policy-offices/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors> Accessed July 25, 2016.

<sup>26</sup> European Commission (EC) Press Release ‘European Commission pushes for full transparency for ISDS in current investment treaties’ Brussels, 29 January 2015.

<sup>27</sup> Settlement of commercial disputes: presentation of a research paper on the Mauritius Convention on Transparency in Treaty-based Investor-State Arbitration as a possible model for further reforms of investor-state dispute settlement. Submitted by the Secretariat on 24 May 2016 for the Commission on International Trade Law Forty-ninth session New York, 27 June-15 July 2016. A/CN.9/890.

<sup>28</sup> Art 30 Vienna Convention.

<sup>29</sup> Chapter IV Vienna Convention.

investment framework. These developments show a phenomenon of forum shifting from the bilateral yet again to the multilateral.

The discipline of international relations provides theories that describe why actors in the international system behave in particular ways. When states and actors of the international system interact with each other, they do so through relationships with one another. Although these particular relationships are important, one must also consider the structural contexts in which these relationships take place. Institutions are structures that are part of these contexts, and their role can be evidenced in the ways that such institutions can constrain but also enable actors' behaviour. This is a modified approach to concepts of structural power in international relations.<sup>30</sup> By a similar token, there is also the conception of contested multilateralism put forward by Morse and Keohane (2014) that states that "contemporary multilateralism is characterized by competing coalitions and shifting institutional arrangements, informal as well as formal."<sup>31</sup> They claim that "[f]requently, multilateral institutions are challenged through the use of other multilateral institutions, either without resort to unilateralism or bilateralism or in conjunction with those strategies."<sup>32</sup> The value of these theories as lenses for the international investment framework lies in their usefulness to understand the latest developments indicating forum shifting, in this case, the state's recourse to discuss amendments of foreign investment rules at the multilateral level.

As discussed in section 1, there are two main arbitral rules involved in the enforcement of the international investment framework, the institutions from which derive, therefore, deserve some consideration. ICSID, one of the five agencies of the World Bank, and the UN, through its bodies like UNCTAD and UNCITRAL. ICSID was created by a multilateral convention as a specialized institution for settling investor-state disputes. As Table 1 shows, ICSID has been the key enforcer of the rules of the international investment framework and has issued many arbitral awards. But, as pointed out by Shihata (1986): "Similarly to the World Bank, to which it is tightly connected....ICSID should be considered as an instrument of international policy to promote investments and economic development."<sup>33</sup> On the other hand, the UN bodies, UNCITRAL, and also UNCTAD, were created to aid developing countries. Just this formal veil might influence the preference of the majority of actors in the framework, the developing states, towards sympathizing with one institution rather than the other.

However, the institutional response to the criticisms of the framework provides an explanation for why a forum shift developed. The criticisms regarding the lack of transparency forced ICSID to change its rules in 2006, but the changes were minimal and so the criticisms remained. Furthermore, even though ICSID settles disputes between states and investors, nationals of other states, the members of the ICSID Convention are only states. This poses a difficulty for other actors that became relevant to the international investment framework, such as the European Union. The European Union, since the Treaty of Lisbon, signed in 2009, gained more "actorness" in the international investment framework. Since then agreements on foreign direct investments are under the supervision of the European Commission.<sup>34</sup> The difficulty for a supranational organization as the EU is that ICSID only accepts states and considers what the parties agreed

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<sup>30</sup> Power analysed herein keeps the parsimony of structural realism. Susan Strange spelled out a concept of structural power where structures are sources of power, but she dismissed institutions and international regimes. Thus, this is a modified approach that considers institutions and international law as structures as well, understanding a concept of power that includes relationships and structures within the concept. For further reading see Strange, S. *States and Markets* Pinter Publishers Limited. London. 1988; Krasner, S 'Structural causes and regime consequences: regimes as intervening variables' in *International Regimes* Edited Stephen Krasner Cornell University Press 1983; Keohane, R 'Theory of World Politics: Structural Realism and Beyond' in *Neorealism and its critics*. Edited by Robert O. Keohane New York: Columbia University Press 1986; Gwynn, M.A. "Structural Power in International Relations and International Law" GLF Working Paper-forthcoming.

<sup>31</sup> Morse, J. and Keohane, R. "Contested multilateralism" *Rev Int Organ* 9:385-412. 2014

<sup>32</sup> Morse, J. and Keohane, R. "Contested multilateralism" *Rev Int Organ* 9:385-412. 2014. p.386

<sup>33</sup> Shihata, I. *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA*, ICSID Review—Foreign Investment Law Journal, Vol. 1, No. 1, pp. 1-15. 1986. p. 6. Author's translation of the Spanish original.

<sup>34</sup> Lisbon Treaty on the Functioning of the European Union, Article 3. See also European Union (EU) Regulation No. 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between member states and third countries.

upon in the treaty. This difficulty has been reflected in practice with cases in which the participation of the EU was limited.<sup>35</sup>

The lack of a broader scope of the transparency rules implemented by ICSID rules was not enough to mitigate the criticism towards the enforcement of investment treaties. An example can be seen in the reaction of some South American countries which started terminating their convention with ICSID because they blamed the institution for unintended sovereignty costs in the form of restriction to regulate.<sup>36</sup> Coupled to this was the discontent of relevant actors with their limited participation in the disputes submitted to ICSID. In 2013, the European Commission stated: “We also have the possibility to influence the multilateral context, for example through the United Nations Commission on International Trade Law (UNCITRAL) — where we have created new rules on transparency that will apply beyond the EU’s own investment agreements.”<sup>37</sup> Furthermore, the European Commission, in a draft text for the Transatlantic Trade and Investment Partnership (TTIP) which was under negotiation with the United States, proposed the creation of a new Investment Court system.<sup>38</sup>

The new UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration are very broad in scope so as to make the whole arbitration process transparent. UNCITRAL also prepared a draft so that the transparency rules may be applied retroactively; this was later approved at the UN General Assembly as the Mauritius Convention. These actions overcome some of the criticism of the different actors involved in the international investment framework, and using these rules in investment disputes does not limit the participation of actors like the EU, either as a party or in the application of their legislation.

A modified structural approach describes that institutions may enable actors to change the rules peacefully but the choice of states on a particular forum, or in this case to choose another forum to contest the existing rules or to further amendments, might be connected to the actors’ dissatisfaction with the partial amendments to the rules or limited access to use the main institutional facilities. This is how the institutional contestation arises. As described by the theoretical background, “the phenomenon of contested multilateralism occurs when states and/or non-state actors either *shift their focus from one existing institution to another* or create an alternative multilateral institution to compete with existing ones.”<sup>39</sup> Actors that faced difficulties with not being accommodated at one of the institutions in the investment framework shifted their efforts to another relevant institution. Institutions, when considered as structures that enable actors’ behaviour, provide power to these actors to affect outcomes. These actions are reflected in scenarios of contested multilateralism which describes the shift from the bilateral establishment of rules to the discussion of improving the foreign investment rules at a multilateral level, as the case of the transparency provisions in the dispute settlement mechanism has shown. Furthermore, it also describes the situation of countries agreeing to modify the rest of the criticized rules of the international investment framework at a multilateral forum like the UN.<sup>40</sup> The aforementioned developments have indirectly made the UN once again an attractive forum for regulating investment rules.

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<sup>35</sup> In cases between two European countries, request to apply EU legislation was denied (Eastern Sugar BV (Netherlands) v. The Czech Republic (SCC no. 088/2004), and participation of the EU was only allowed through third party amicus curiae submissions (Electrabel SA v. Republic of Hungary (ICSID Case No. ARB/07/19)).

<sup>36</sup> Although the enforcement problem was connected to the rules and not the institution, some of these countries blamed ICSID for the sovereignty costs in the form of restriction to regulate. See Brazil’s position in Peterson, L. and Simoes e Silva, A. *Investment Arbitration Reporter* 1 (9) 2008; Ecuador’s allegation of sovereignty costs in Interview by Mena Erazo, Paul. BBC News report. September 16, 2010; Venezuela’s statement in Digital news reported by Agencia Venezolana de Noticias (AVN) on January 15, 2012; Argentina’s request of termination of the ICSID Convention in Argentina’s Draft of Law. File No. 1311-D-2012. H. Camara de Diputados de la Nacion. March 21, 2012; See also Vandeveld, K. “A Brief History of International Investment Agreements” University of California at Davis *Journal of International Law and Policy*. Vol.12. 2005-2006.

<sup>37</sup> EC. Fact Sheet. ‘Investment Protection and Investor-to-State Dispute Settlement in EU agreements’ Executive Summary. November 2013.

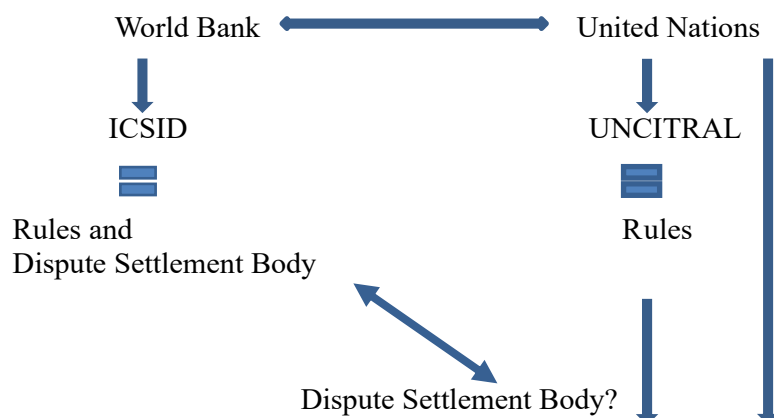
<sup>38</sup> European Commission draft text for the TTIP, Investment, Chapter II, section 3.

<sup>39</sup> Morse, J. and Keohane, R. “Contested multilateralism” *Rev Int Organ* 9:385-412. 2014. p.387. Emphasis added.

<sup>40</sup> By agreeing to a convention similar to the Mauritius convention, or using the latter as a complement.



Figure 1. Institutional Power and Contested Multilateralism in the area of International Investments.



### Conclusion

The public interest matters in the area of international investments. Rules should encompass the interests of all actors in the international investment framework. These include states but also some key non-state actors, investors and also NGOs, civil society and regional economic integration organizations. Such an inclusion would likely result in the agreement of provisions or rules that are balanced for all actors, which in turn would allow for more sustainable development.

Different multilateral institutions might provide the platform for this task, but the choice of which institution to use might fall on the one that allows all actors' interests to be considered. UNCITRAL's work on the Transparency Rules and the Mauritius Convention has proven that UNCITRAL is a suitable organization to prepare the work for such a great challenge as the amendment or improvement of existing regulation of foreign investment.<sup>41</sup> The UNCITRAL Rules on Transparency also give access to the non-state actors affected by the investment treaties.

Therefore, having the United Nations as the forum for the discussions about improving the rules of the current international investment framework by a meta-treaty is a promising step forward towards achieving balanced rules in this area. At the multilateral level, actors' asymmetries get diminished far more than at a bilateral setting. It is not a coincidence that the foreign investment rules developed at the multilateral level (UN) in the 1950s to 1970s favoured the developing countries' interests. This does not mean that it will be a detriment for other countries. Establishing rules that protect the public welfare are the goal and are in the interest of all countries. Furthermore, the inclusiveness provided by a multilateral setting allows countries which are not aware of certain matters to become aware of an issue that might matter to them, just by listening to the different issues that are being raised by other countries at such a forum.

The establishment of rules at such fora might take longer and be more difficult, but the deficiencies of the current international investment framework have proven the problems that can derive from agreeing to something just because it is faster and more convenient. This is comparable to the effect of acquiring a cheap product that turns out to be of bad quality and inevitably does not last long. Further work to improve the current international investment framework lies in states' increase awareness of the advantages of a multilateral forum. It promises more success in overcoming the existing deficiencies, because actors at such a forum can reach an agreement on rules that are balanced because the rules reflect the interests of all parties at stake in the framework.

<sup>41</sup> See the advantages of the participation in UNCITRAL's work and its decision reached by consensus in Nicholas, C. 'Negotiations and the Development of International Standards in Public Procurement: Let the Best Team Win?' 7(1) Trade Law and Development 64. 2015. p.76-79.

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## ***Session 8 — International framework on arbitration: where are the needs?***

### *Opening Oceania: Reforming International Arbitration Regimes Across the Pacific Islands*

Colin Ballantine

#### *1. Introduction*

Across the Pacific Ocean lie a number of small island nations that can broadly be categorised into three ethno-cultural sub-regions: Melanesia, Micronesia and Polynesia. Together, these sub-regions form ‘Oceania’, and include the independent nations of Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Samoa, the Solomon Islands, Tonga, Tuvalu and Vanuatu. Several non-independent territories are also located in the region, including American Samoa, the Cook Islands, French Polynesia, New Caledonia, Niue, Tokelau and Wallis and Futuna.

The region contains some of the fastest-growing economies in the world.<sup>1</sup> However, foreign investment is critical in order for the region to sustain its economic potential. Additional capital and expertise from foreign investors can fund new industries and expand existing ones, lift infrastructure and productivity, and establish employment opportunities. With almost one third of exclusive economic zones globally,<sup>2</sup> there are significant opportunities in the region for the exploration and use of marine resources, including energy production from water and wind, and deep seabed mining.

Foreign investment in Oceania is inhibited by laws in the region that lack clarity and are poorly enforced.<sup>3</sup> One solution to this is to develop the practice of international arbitration, which allows foreign investors to resolve private disputes before foreign arbitrators, under foreign laws, instead of before local judges, under local laws.<sup>4</sup> Most regions around the world have developed international arbitration regimes, but Oceania is an exception. In order to attract foreign investment, countries in Oceania should therefore enact updated legislation for international arbitration.

There is a lack of discourse on the applicability of international arbitration to Oceania. By analysing how international arbitration can facilitate greater cross-border trade with Oceania, this paper seeks to fill a void in discourse, and serve as a platform for necessary international arbitration reforms within the region.

#### *2. Obstacles to Foreign Investment in Oceania*

##### *1. Inadequacy of dispute resolution*

A successful dispute resolution system is necessary in order to facilitate cross-border trade, as it assures foreign investors that contractual rights and obligations will be upheld.<sup>5</sup> If such rights and obligations are not upheld, foreign investors will invest into other countries where they will be upheld, or will import their

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<sup>1</sup> For example, Nauru’s gross domestic product is forecast to expand by 15.0% in 2017. See: Asian Development Bank, *Asian Development Outlook 2016 Update: Meeting the Low-Carbon Growth Challenge*, (Manila: Asian Development Bank, 2016).

<sup>2</sup> Henrike Seidel and Padma N. Lal, *Economic value of the Pacific Ocean to the Pacific Island Countries and Territories*, (Switzerland: IUCN Oceania, 2010).

<sup>3</sup> Anita Jowitt, “The Future of Law in the South Pacific,” *Journal of South Pacific Law* 12, no. 1 (2008), 45 and 47.

<sup>4</sup> Queen Mary University of London, *2015 International Arbitration Survey: Improvements and Innovations in International Arbitration*, (London: Queen Mary University of London, 2015).

<sup>5</sup> Chief Justice Robert French AC, “International Commercial Dispute Resolution and the Place of Judicial Power,” (Speech, International Commercial Law and Arbitration Conference, Law Courts Building, Sydney, August 22, 2013).

own labour and resources to manage the greater risks of a country lacking fair and balanced dispute resolution.<sup>6</sup>

Oceania does not currently have a dispute resolution framework in place that encourages foreign investment.

(a) *Litigation in Oceania*

Many countries in Oceania face issues with corruption and rule of law.<sup>7</sup> For example, Papua New Guinea's Attorney-General, a Supreme Court judge and the Prime Minister's lawyer were all charged with corruption and fraud in 2016.<sup>8</sup> This creates a perception that claims heard by local courts may not always be treated fairly.

(b) *Litigation in an overseas jurisdiction*

Given the limited number of reciprocal enforcement agreements in place for foreign court judgments, a judgment of a foreign court may not be enforceable in Oceania. If a losing party under a foreign court judgment only had assets which were located in Oceania, this would render the foreign court judgment effectively worthless.

(c) *International arbitration*

Some countries in Oceania have not yet enacted arbitration legislation.<sup>9</sup> Many other countries in the region have not reformed their arbitration legislation for several decades.<sup>10</sup> As a result, many widely adopted reforms which have improved the practice of international arbitration in other regions are not yet available in Oceania.

(d) *Others*

Other forms of alternative dispute resolution do not always produce final and binding outcomes.<sup>11</sup> In particular, mediation lacks the safety net of an institutional structure, with control over its outcome being held by the parties. This does not satisfy desire of foreign investors for certainty and predictability.<sup>12</sup>

## II. *Lack of law reform*

Foreign investors prefer to invest in countries that maintain efficient and modern laws, instead of outdated laws that are poorly understood. For example, jurisdictions that regularly reform their laws on international arbitration, such as Hong Kong and Singapore, are among the top recipients of foreign investment globally.<sup>13</sup>

<sup>6</sup> Asian Development Bank, *Reforming Pacific Contract Law* (2009 report), (Manila: Asian Development Bank, 2009), 17.

<sup>7</sup> Peter Larmour and Manuhua Barcham, *National Integrity Systems: Pacific Islands* (2004 report), (Victoria, Australia: Transparency International, 2004), 5.

<sup>8</sup> "PNG's Attorney-General Ano Pala arrested by country's fraud squad over misuse of funds." *ABC News*. Apr. 12, 2015. <http://www.abc.net.au/news/2016-04-12/png-justice-minister-ano-pala-arrested/7320984>.

<sup>9</sup> For example, as of December 2016, the Marshall Islands and Tonga have no arbitration law.

<sup>10</sup> Asian Development Bank, *Technical Assistance Report: Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific* (2016 report), (Manila: Asian Development Bank, 2016), 2.

<sup>11</sup> Kim M. Rooney, "Conciliation and Mediation of International Commercial Disputes in Asia and UNCITRAL's Working Group on the International Enforcement of Settlement Agreements," *Asian Dispute Review* 2016, no. 4 (2016), 196.

<sup>12</sup> Amanda Perry, "An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality," *American University International Law Review* 15, no. 6, (2000), 1628.

<sup>13</sup> United Nations Conference on Trade and Development, *World Investment Report 2015* (2015 report), (Geneva: UNCTAD, 2015), 5.

Oceania has a long history of colonialism, the legacy of which is demonstrable in the laws that govern the region today.<sup>14</sup> Many laws that were introduced pre-independence were saved post-independence, to plug any gaps until they could be replaced by locally enacted laws. However, locally enacted laws have often been slow to emerge in the region. For example, the current arbitration law of Papua New Guinea was passed in 1951.<sup>15</sup>

A law reform agency could assist in modernising Oceania's colonial-era laws. Such reform would make the region more attractive to foreign investment. However, according to Peter MacFarlane and Chaitanya Lakshman, "there is little commitment to law reform by South Pacific states."<sup>16</sup> Many countries in Oceania only have inactive or informal law reform agencies, due to limited expertise and low financial resources.<sup>17</sup>

Law reform instigated by international organizations has also been limited. Such organizations have taken a generalist approach, pursuing reforms in a multitude of areas, including governing business operations (company law), closure (bankruptcy law), transactions (contract law) and dispute resolution.<sup>18</sup> However, certain reforms have been prioritised over others, given limited resources. As a result, although reforms have been achieved in certain areas,<sup>19</sup> reforms in many other areas, like international arbitration, have not.<sup>20</sup>

### III. Prevalence of customary law

Customary laws include traditional social, religious and economic values and understandings carried on by an identifiable community.<sup>21</sup> Such laws are recognized by many jurisdictions in Oceania as a source of law.<sup>22</sup> In certain jurisdictions in the region, customary law also holds a higher status than common law and equity.<sup>23</sup>

Courts in Oceania have applied customary law often.<sup>24</sup> For example, a court in Tonga has implied customary terms into an employment contract such that, because of established customs within local workplaces, it is now permissible for a replacement worker to work the shift of another worker who is unavailable.<sup>25</sup> Customs have also been cited in decisions on whether an agreement has been concluded,<sup>26</sup> and misrepresentation.<sup>27</sup>

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<sup>14</sup> For further context, see: Jennifer Corrin Care, "Contract law — The South Pacific: customary and introduced law," *Amicas Curae*, no. 23 (2000), 26.

<sup>15</sup> Arbitration Act 1951 (PNG).

<sup>16</sup> Peter MacFarlane and Chaitanya Lakshman, "Law reform in the South Pacific," *Journal of South Pacific Law*, 9, no. 1 (2005).

<sup>17</sup> *Ibid.*

<sup>18</sup> For example, the Asian Development Bank's Pacific Private Sector Development Initiative, which is analysed below.

<sup>19</sup> For example, see: Asian Development Bank, *Pacific Private Sector Development Initiative: Progress Report* (2013-2014 report), (Manila: Asian Development Bank, 2014).

<sup>20</sup> *Technical Assistance Report: Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific* (see footnote 10 above), 1.

<sup>21</sup> Bob Hughes and Peter MacFarlane, "The Application of Custom in South Pacific Contract Law and as a Basis for an Estoppel," *Journal of Contract Law* 20, no. 1 (2004), 36.

<sup>22</sup> *Ibid.*

<sup>23</sup> Jennifer Corrin Care, "Cultures in Conflict: the Role of the Common Law in the South Pacific," *Journal of South Pacific Law* 6, no.2 (2002).

<sup>24</sup> Desley Horton, "International Commercial Arbitration in Pacific Island States," (Speech, Wilmer Cutler Pickering Hale and Dorr LLP, London, United Kingdom, May 20, 2016).

<sup>25</sup> *Vaiioleti v Cross and The Commodities Board* [1990] Tonga LR 108.

<sup>26</sup> "International Commercial Arbitration in Pacific Island States" (see footnote 24 above).

<sup>27</sup> *John To'Ofilu v Oimae*, Unreported, High Court, Solomon Islands, CAC 5/96, 19 June 1997.

As there is not yet a uniform code on the applicability of customary law to contracts in Oceania,<sup>28</sup> the existence of customary law introduces an element of unpredictability for foreign investors operating in the region.

#### *IV. Limited local legal profession*

There is a shortage of lawyers in Oceania. For example, it was suggested in 2011 that there was just one lawyer for every 13,616 people in the Solomon Islands, in comparison to one lawyer for every 351 people in Australia.<sup>29</sup> It has also been reported that some islands in the region, such as Kiritimati, have no resident legal professionals at all.<sup>30</sup> The cost of legal services in Oceania is therefore higher than it is in other regions.<sup>31</sup> This restricts foreign investment, as foreign investors are attracted to countries that offer low transaction costs.<sup>32</sup>

The quality of legal services in the region is also inhibitive for foreign investment. As Carolyn Penfold notes, “many South Pacific countries experience considerable difficulty with unethical and unprofessional behaviour within the legal system.”<sup>33</sup> With “inadequate supervision and support structures” and “poor pay and conditions,”<sup>34</sup> foreign investors may question the ability of local lawyers to advocate complex points of law.

The capacity of the region to develop a larger and higher quality legal profession is prohibited by a lack of locally-based tertiary-level institutions,<sup>35</sup> and institutions to supervise, support and discipline legal professionals.<sup>36</sup>

#### *3. International Arbitration to Facilitate Foreign Investment in Oceania*

International arbitration could address a number of the concerns of foreign investors doing business in Oceania, such as:

##### *(a) Quality of local legal system*

In international arbitration, foreign arbitrators and counsel are largely permitted to oversee a dispute in place of local judges and counsel. This allows foreign investors to manage risks of corruption and inadequate supervision within Oceania’s legal profession. Foreign arbitrators and counsel may also offer industry-specific expertise, which would otherwise be unavailable in the region.

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<sup>28</sup> Many countries in the region have not yet introduced a code of contract law, despite the possibility that it could work to address the applicability of customary law to particular contracts. See: “Contract law — The South Pacific: customary and introduced law,” (see footnote 14 above), 30.

<sup>29</sup> South Pacific Lawyers’ Association, *Needs Evaluation Survey for South Pacific Lawyer Associations* (2011 report), (Canberra: South Pacific Lawyers’ Association, 2011).

<sup>30</sup> “Justice delayed, justice denied on Pacific’s remote Kiritimati.” *Reuters*. Apr. 26, 2016. <http://www.reuters.com/article/us-pacific-justice-idUSKCN0XN2VN>.

<sup>31</sup> *Reforming Pacific Contract Law* (see footnote 6 above), 17.

<sup>32</sup> “An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality” (see footnote 12 above), 1630.

<sup>33</sup> Carolyn Penfold, “Teaching Legal Ethics and Professionalism in a South Pacific Context,” *Legal Education Review* 23, no. 1 (2013), 19.

<sup>34</sup> *Ibid.*, 22.

<sup>35</sup> For many countries in Oceania, the only accessible tertiary-level institution is The University of The South Pacific, which is jointly owned by the governments of 12 member countries. See: “About the University.” *The University of The South Pacific*. Date unknown. [http://www.usp.ac.fj/index.php?id=usp\\_introduction](http://www.usp.ac.fj/index.php?id=usp_introduction).

<sup>36</sup> “Teaching Legal Ethics and Professionalism in a South Pacific Context” (see footnote 33 above), 15.

(b) *Prevalence of colonial-era and customary laws*

International arbitration largely allows parties to select their own procedural rules and substantive law, to govern their disputes. For example, parties could agree to have a dispute seated in Singapore, but determined for the most part, in accordance with Hong Kong law. This reduces the risk of inefficient colonial-era or unpredictable customary laws applying to a dispute in a jurisdiction in Oceania.

(c) *Unenforceability of foreign court judgments*

Most countries have acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).<sup>37</sup> Under the New York Convention, countries must recognize and enforce arbitral awards made in other contracting countries. This addresses the limited number of reciprocal enforcement agreements in place in Oceania for foreign court judgments.

However, many of these benefits of international arbitration are not available in Oceania. This is because some jurisdictions in the region have not yet enacted arbitration legislation,<sup>38</sup> while many others have not updated their arbitration legislation for several decades. Accession to the New York Convention has also been limited (though the New York Convention has been extended to some non-independent Oceanic territories).<sup>39</sup>

I. *Legislative frameworks*

The United Nations Commission on International Trade Law (UNCITRAL) has developed a model law to govern the practice of international arbitration (Model Law).<sup>40</sup> The Model Law has successfully been enacted by states in its full form, and therefore requires a low level of scrutiny by law-making bodies.

By enacting the Model Law and other reforms, countries in Oceania will address many shortcomings in their current arbitration legislation, including:

(a) *Jurisdiction*

The Model Law provides for a tentative competence of arbitral tribunals to decide on their own jurisdiction, either as a preliminary question or in an award on the merits.<sup>41</sup> Answering a preliminary question such as “is there an agreement to arbitrate this dispute,” may consume as many resources as resolving the underlying dispute itself.<sup>42</sup> Therefore, shifting such questions from judges to arbitrators can improve the efficiency of a legal system.<sup>43</sup> This would be useful in Oceania, where it has been suggested that more than 10,000 court judgments are waiting to be delivered in Papua New Guinea, and that some disputes are still before Vanuatu’s courts that were filed prior to 2001.<sup>44</sup>

(b) *Procedure*

Due to the limited number of legal professionals in Oceania, industry specialists such as engineers have often been appointed to act as arbitrators, regardless of whether they are familiar with common

<sup>37</sup> “Contracting States.” *New York Arbitration Convention*. Date unknown. <http://www.newyorkconvention.org/countries>.

<sup>38</sup> Mele Tupou, “Setting the Scene,” (Speech, Wilmer Cutler Pickering Hale and Dorr LLP, London, United Kingdom, May 19, 2016).

<sup>39</sup> “Status of signatories.” *SICE*. Date unknown. [http://www.sice.oas.org/DISPUTE/comarb/uncitral/nysig\\_e.asp](http://www.sice.oas.org/DISPUTE/comarb/uncitral/nysig_e.asp).

<sup>40</sup> UNCITRAL Model Law on International Commercial Arbitration 1985, with Amendments as Adopted in 2006 (Vienna, United Nations, 2006).

<sup>41</sup> *Ibid.*, art 16.

<sup>42</sup> Amokura Kawharu, “Arbitral jurisdiction” *New Zealand Universities Law Review* 23 no 2 (2008), 239.

<sup>43</sup> Gary B. Born, “International Arbitration Agreements and Competence-Competence,” in *International Commercial Arbitration (Second Edition)* (London: Kluwer Law International, 2014), 1074-1075.

<sup>44</sup> “International Commercial Arbitration in Pacific Island States,” (see footnote 24 above).

practices in arbitral procedure.<sup>45</sup> Importing articles 10 to 24 of the Model Law would address this. These articles act as a safeguard for instances where parties cannot agree between themselves as to arbitral procedure, including as to the form of oral hearings and written submissions.

(c) *Interim relief*

The current arbitration laws of Oceania make limited reference to interim relief. Although Samoa's arbitration law does make provision for arbitrators to render an interim award, it does not define what this is.<sup>46</sup> In contrast, the Model Law provides for both a court-ordered interim measures regime in support of arbitration, as well as for an arbitral tribunal-ordered interim measures regime.<sup>47</sup> By enacting the Model Law, countries in Oceania would give arbitrators explicit powers to preserve the status quo, prevent prejudice to the arbitral process, preserve assets and evidence, and make preliminary orders.<sup>48</sup>

(d) *Interest*

In early common law legal provisions, arbitrators possessed limited authority to award interest on arbitral awards.<sup>49</sup> Many jurisdictions have since amended their laws to include express powers for arbitrators to award simple or compound interest in respect of any period up to payment under an arbitral award.<sup>50</sup> However, Oceanic jurisdictions have not. This was identified in a recent Papua New Guinean case, where Kandakasi J expressed that Papua New Guinea should "take steps to review and introduce reforms to our Arbitration Act".<sup>51</sup> By enacting a rate and timeframe within which arbitrators can award interest, countries in Oceania will encourage compliance with arbitral awards.

(e) *Court intervention*

Arbitration laws in Oceania do not provide for the same degree of certainty as that of Model Law jurisdictions. For example, if a party in Samoa alleges fraud, a court is immediately granted authority to determine the dispute in place of the arbitral tribunal.<sup>52</sup> Parties in the region can also challenge arbitral awards merely for arbitrator 'misconduct' and without any time limits.<sup>53</sup> In contrast, the Model Law sets out an exhaustive list of high-threshold situations which warrant recourse to a court to set aside an arbitral award.<sup>54</sup> It also sets a strict time limit within which such applications must be made.<sup>55</sup> By enacting the Model Law, countries in Oceania would therefore improve the certainty and finality of arbitral awards.

## II. *Institutional support*

In developed jurisdictions, institutional bodies support the development of foreign investment. In Oceania, there are only a limited number of such institutions that are active.

(a) *Arbitral institutions*

The most accessible arbitral institutions for parties operating in Oceania are the Australian Centre for International Commercial Arbitration (ACICA), based in Sydney, Australia, and the Arbitrators' and

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<sup>45</sup> For example, *Samoa National Provident Fund v Apia Construction and Engineering Ltd* [2008] WSSC 1, 102 and 113.

<sup>46</sup> Arbitration Act 1976 (Samoa), s 6 and Sch 1.

<sup>47</sup> UNCITRAL Model Law (see footnote 40 above), arts 17 and 17J.

<sup>48</sup> *Ibid.*, arts 17A-17H.

<sup>49</sup> *Evaluation Consult (New Zealand) Ltd v Independent State of Papua New Guinea* [2016] PGNC 50, 3.

<sup>50</sup> See, for example: International Arbitration Act (Cap 143A) (Singapore), s 12(4).

<sup>51</sup> [2016] PGNC 50 (see footnote 49 above), 38.

<sup>52</sup> Horton, "International Commercial Arbitration in Pacific Island States," (London, UK, 2016).

<sup>53</sup> See, for example: Arbitration Act 1976 (Samoa), s 13.

<sup>54</sup> UNCITRAL Model Law (see footnote 40 above), art 34(2).

<sup>55</sup> UNCITRAL Model Law (see footnote 40 above), art 34(3).

Mediators' Institute of New Zealand (AMINZ), based in Wellington, New Zealand. ACICA has heard disputes involving parties from Fiji and Papua New Guinea.<sup>56</sup> It has also administered mediator training courses in Fiji.<sup>57</sup> Other than these activities, information on the presence of arbitral institutions in the region is limited.

(b) *Pacific Private Sector Development Initiative*

The Asian Development Bank's Pacific Private Sector Development Initiative (PSDI), based out of Sydney, Australia, promotes commercial law reform in Oceania. Although dispute resolution is part of PSDI's mandate, PSDI has had limited success in overseeing arbitration-related developments in Oceania: the only reference to arbitration in its 'Progress Report' for 2014-2015 was in respect of an Arbitration Bill for Tonga, which it referred to as still being on hold,<sup>58</sup> as it was in its 2013-2014 report.

(c) *Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific*

In 2016, the Asian Development Bank established an arbitration-specific project, called Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific (Project).<sup>59</sup> The Project will assist countries in Oceania with acceding to the New York Convention and enacting arbitration laws that implement the New York Convention.<sup>60</sup> The initial target nations of the Project are Fiji, Papua New Guinea and Tonga.<sup>61</sup> Further expansion of the Project will depend on additional funding.

(d) *Pacific Judicial Development Programme*

The Pacific Judicial Development Programme (PJDP) was established to strengthen the rule of law in Oceania through judicial training programmes.<sup>62</sup> Court users in the region have noted an improvement in the standard of judicial conduct, as a result of PJDP's activities.<sup>63</sup> This is a positive development, as the growth of international arbitration depends on the quality of the judiciary overseeing it.<sup>64</sup> Although PJDP has not focused on international arbitration specifically, a series of recent court decisions from the region support the view that courts in Oceania are becoming increasingly pro-arbitration.<sup>65</sup>

(e) *South Pacific Seminars*

UNCITRAL's Regional Centre for Asia and the Pacific has also been active in the region. It hosted a 'South Pacific Seminar' in Papua New Guinea in 2015 and 2016. These seminars have included sessions in respect of the New York Convention and the Model Law.<sup>66</sup> UNCITRAL's efforts have been effective to

<sup>56</sup> Deborah Tomkinson and Margaux Barhoum. "Australian Centre for International Commercial Arbitration." In *Arbitration World (Fifth Edition)*, edited by Karyl Nairn QC and Patrick Heneghan. (London: Thomson Reuters, 2015).

<sup>57</sup> "Mediator Training — Fiji." *Australian Disputes Centre*. Date unknown. <https://disputescentre.com.au/events/mediation-training-fiji/>.

<sup>58</sup> Asian Development Bank, *Pacific Private Sector Development Initiative: Progress Report* (2014-2015 report), (Manila: Asian Development Bank, 2015), 73.

<sup>59</sup> "Regional: Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific." *Asian Development Bank*. Date unknown. <https://www.adb.org/projects/50114-001/main>.

<sup>60</sup> *Technical Assistance Report: Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific* (see footnote 10 above).

<sup>61</sup> *Ibid.*, 5.

<sup>62</sup> "Pacific Judicial Development Programme — About Us." *Federal Court of Australia*. Date unknown. <http://www.fedcourt.gov.au/pjdp/about-us>.

<sup>63</sup> "Explanatory Note by the UNCITRAL secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006." *United Nations Commission on International Trade Law*. Date unknown. <http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/MLARB-explanatoryNote20-9-07.pdf>.

<sup>64</sup> Chief Justice Allsop, "Australia — a vital commercial hub in the Asia Pacific region: the importance of and challenges for Australian commercial courts and arbitral institutions," (Speech, Melbourne, Feb. 25 2015).

<sup>65</sup> For example, see: *SNPF v Westerlund Construction Joint Venture* [2016] WSSC 26.

<sup>66</sup> "2015 UNCITRAL South Pacific Seminar — Programme." *UNCITRAL Regional Centre for Asia and the Pacific*. Date unknown. <http://www.uncitral.org/images/RCAP/Image.1439368216598.jpg>.



some degree, with Papua New Guinea announcing its intention to move forward with accession to the New York Convention at the 2016 seminar.<sup>67</sup>

#### 4. *Proposals for International Arbitration Reform in Oceania*

##### I. *Legislative frameworks*

In order to become a more acceptable place for the practice of international arbitration, countries in Oceania must first accede to the New York Convention, as most countries around the world have done. This requires the deposit of a notice of accession with the New York Convention's Secretariat.<sup>68</sup> New arbitration legislation based on the Model Law should then be enacted by these countries, to implement the New York Convention.

The Model Law is universally recognized as representing the best practice in international arbitration. UNCITRAL's formal Explanatory Note to the Model Law comments on the substance of the Model Law as follows:

"The Model Law" ... "covers all stages of the arbitral process from the arbitration agreement to the recognition and enforcement of the arbitral award and reflects a worldwide consensus on the principles and important issues of international arbitration practice. It is acceptable to States of all regions and the different legal or economic systems of the world. Since its adoption by UNCITRAL, the Model Law has come to represent the accepted international legislative standard for a modern arbitration law and a significant number of jurisdictions have enacted arbitration legislation based on the Model Law."<sup>69</sup>

In order to optimise the positive perception that the adoption of the Model Law will have on countries in Oceania, the Model Law should be enacted without significant change. However, further reforms to assist the region in becoming an acceptable place for international arbitration should also be considered, including:

##### (a) *Arbitrability*

Under the New York Convention, arbitration agreements must deal with a "subject matter capable of settlement by arbitration."<sup>70</sup> However, some jurisdictions have recently removed restrictions on what types of disputes can be arbitrated.<sup>71</sup> Countries in Oceania may wish to do the same in respect of certain types of insurance, intellectual property and shareholder disputes. Trust arbitration may also be relevant to the region, given that countries like Samoa have developed offshore financial centres.<sup>72</sup>

##### (b) *Arbitrator and counsel appointments*

Countries in Oceania should eliminate visa requirements for arbitrators and requirements as to arbitrators' backgrounds. These measures would uphold the principle of party autonomy, by providing

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<sup>67</sup> *Technical Assistance Report: Promotion of International Arbitration Reform for Better Investment Climate in the South Pacific* (see footnote 10 above), 3.

<sup>68</sup> Gary B. Born, "Integration and international dispute resolution in Small States — Keynote Speech," (Speech, London, May 19 2016).

<sup>69</sup> "Explanatory Note by the UNCITRAL secretariat on the 1985 Model Law on International Commercial Arbitration as amended in 2006" (see footnote 63 above).

<sup>70</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York: United Nations, 1958), art 2(1).

<sup>71</sup> For example, Hong Kong has recently introduced amendments to its arbitration legislation, clarifying that disputes over intellectual property rights can be resolved by way of arbitration. See: "Hong Kong confirms IP rights are arbitrable." *Herbert Smith Freehills*. Dec. 7, 2016. <http://hsfnotes.com/arbitration/2016/12/07/hong-kong-confirms-ip-rights-are-arbitrable/>.

<sup>72</sup> "Overview of Samoa." *Samoa International Finance Authority*. Date unknown. [http://sifa.ws/index.php/aboutus/overview\\_of\\_samoa/](http://sifa.ws/index.php/aboutus/overview_of_samoa/).

parties with a wide scope to select the arbitrator that they feel is best determined to hear a dispute. Restrictions on rights of audience in arbitration-related court proceedings should also be relaxed. This is because a larger pool of counsel to select from would reduce transaction costs for foreign investors.

(c) *Arb-Med*

Arb-Med is a procedure where an arbitral tribunal assumes the role of a mediator or conciliator in order to facilitate settlement of the dispute referred to arbitration. It has become increasingly popular in Asian jurisdictions,<sup>73</sup> and should therefore be facilitated in Oceania too. Without statutory recognition of an Arb-Med process, there is currently a risk that enforcement of an international arbitral award made in Oceania following a failed Arb-Med procedure would be refused.

(d) *Confidentiality*

As confidentiality does not feature in a number of arbitration laws within Oceania,<sup>74</sup> arbitration-related court proceedings may become published. This goes against the expectations that parties have for an arbitral process to be confidential. Countries in Oceania should therefore address this issue, with public interest in any arbitration-related court proceedings being provided for by limited or redacted publications, or publication in full only in exceptional cases.

(e) *Indemnity costs*

Countries in Oceania should introduce a default cost rule in respect of arbitration-related court proceedings. In such a framework, debtors who unsuccessfully apply to stay arbitrations or set aside an arbitral award would be required to pay the costs of the arbitration-related court proceedings on an indemnity basis.<sup>75</sup> This would improve the certainty and finality of arbitral awards, by deterring the use of court-based guerrilla tactics to challenge such awards.

(f) *Third party funding*

Some jurisdictions have abolished the common law torts of champerty and maintenance, and now permit the use of third party funding in international arbitration. In light of the limited resources of local parties in the region, countries in Oceania may wish to consider similar reforms. Such reforms may need to be accompanied by detailed regulations in respect of conflicts of interest, disclosure and eligibility requirements for funders.

## II. *Institutional support*

Besides legislative reform, there are a number of other ways in which governments in Oceania can encourage the development of international arbitration and facilitate greater foreign investment, including:

(a) *Arbitral institutions*

Most users of international arbitration prefer institutional rather than ad hoc arbitration.<sup>76</sup> This is because arbitral institutions articulate arbitral proceedings comprehensively from start to finish and are better suited to cater for contingencies.<sup>77</sup> No international arbitral institution is based in Oceania. Oceanic

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<sup>73</sup> Albert Monichino, "The Future of International Arbitration in Australia," *Victoria University Law and Justice Journal* 5, no. 1 (2015), part G.

<sup>74</sup> For example, see: Arbitration Act 1976 (Samoa).

<sup>75</sup> "The Future of International Arbitration in Australia" (see footnote 73 above), part H.

<sup>76</sup> *2015 International Arbitration Survey: Improvements and Innovations in International Arbitration* (see footnote 4 above), 17.

<sup>77</sup> "International Arbitration: Which institution?" *Ashurst*. Jan. 3, 2017. <https://www.ashurst.com/en/news-and-insights/legal-updates/qg-international-arbitration-which-institution/>.

governments should therefore support nearby institutions such as ACICA in establishing sub-commissions across the region. This could involve subsidised premises or tax incentives.

*(b) Supranational court*

A supranational court vested with compulsory and exclusive jurisdiction on certain matters could help to create a more unified pool of locally rendered arbitration-related jurisprudence. There would be administrative difficulties in the establishment of such a court, but the concept is not without precedent. For example, the Caribbean Court of Justice — a supranational entity — has itself delivered binding decisions in respect of the enforcement of arbitral awards.<sup>78</sup>

*(c) Taskforce*

A regional taskforce of arbitration practitioners should be created, in order to address the lack of law reform agencies in Oceania. Through annual conferences or symposia, such a taskforce would be well placed to hold governments to account on the progress of arbitration reforms. The taskforce could also consider opportunities for Oceania to develop arbitration-specific expertise in particular industries, like deep sea mining.

*(d) University course*

As of December 2016, the most widespread university in Oceania only teaches “Foreign Trade and Investment Law,” but not any dedicated course on international arbitration.<sup>79</sup> There are a large number of arbitration practitioners in Australia and New Zealand who could establish and teach such a course. This would create a pool of bicultural and bilingual lawyers capable of promoting the benefits of international arbitration to local businesses, in a culturally appropriate manner.

*5. Conclusion*

The aim of this paper has been to demonstrate how international arbitration can assist Oceania in attracting foreign investment. If countries in the region accede to the New York Convention and enact the Model Law, Oceania will offer foreign investors a dispute resolution system with greater enforceability, finality and neutrality. This will address the perceived risks of investing into the region, including the prevalence of colonial-era and customary laws, and the unenforceability of foreign court judgments.

There are economic benefits for Oceania in becoming an acceptable place for the practice of international arbitration. It will promote more travel to, and business in, the region. This will generate revenue for the region’s airlines, hotels and other service providers. The increased number of arbitral and related court proceedings may also create opportunities for the local legal profession. Therefore, countries across the region should prioritise international arbitration reform.

In order to meet the challenges of such reform, a greater degree of co-ordination is needed. ACICA, AMINZ, the Asian Development Bank and UNCITRAL must work more closely with each other and local stakeholders. The use of a unified taskforce, as proposed by this paper, would expedite such co-ordination. By the opening of the 24<sup>th</sup> ICCA Congress in Sydney in April 2018, it is hoped that regional arbitration-related reform will have commenced, ‘Opening Oceania’ to the world.

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<sup>78</sup> Winston Anderson, “Keynote Panel — International B2B Dispute Resolution” (Speech, Wilmer Cutler Pickering Hale and Dorr LLP, London, United Kingdom, May 20, 2016).

<sup>79</sup> “Course Finder: Faculty of Arts, Law & Education — School of Law.” *The University of South Pacific*. Date unknown. <http://sols3.usp.ac.fj/cfinder/pcrsedb.pl>.

*Renegotiation of Indian Bilateral Investment Treaties:  
An Analysis from a Development Perspective*

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*I. Introduction*

Sustainable development refers to State's effort to achieve progress (development) in a way that can be maintained over the long term (sustainable).<sup>1</sup> The most popular definition defines sustainable development as, "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".<sup>2</sup> The Brundtland Report observes that, "Sustainable development is not a fixed state of harmony, but rather a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs".<sup>3</sup> Therefore economic development, social well-being and environmental protection are the key pillars of sustainable development.<sup>4</sup> The concept of sustainable development did not focus on limiting economic activity but rather on re directing development in order to ensure the potential for long term sustained yields.<sup>5</sup> In this background foreign investments are very important in developing economies for implementing the sustainable development agenda. Various initiatives at the international level stressed on the importance of foreign investments in achieving sustainable development.<sup>6</sup>

Foreign investments help to raise Gross Domestic Product (GDP), bring employment options and new technologies, and alleviate poverty. So there are reasons for developing countries to support foreign investments. At the same time it is equally important for a developing State to have policy flexibility and incentives for sustainability. John Ruggie referred this as the "governance gaps created by globalization-between the scope and impact of economic forces and actors, and the capacity of societies to manage their adverse consequences".<sup>7</sup> In order to reconcile these diverse interests, to engage the one so as to promote the other, sustainable development law and policy can and should be developed and implemented within investment regimes.

The treaty-based investment law regime is based on the most powerful system of international adjudication in modern history.<sup>8</sup> Arbitrators have shown pro investment stance and acquired power through expansive legal interpretations and the economic size of the awards.<sup>9</sup> Not coincidentally, there is growing apprehension about the regime and pressure for reform.<sup>10</sup> The increasing facility with which new directions

<sup>1</sup> Marie-Claire Cordonier Segger & Andrew Newcombe, *An Integrated Agenda for Sustainable Development in International Investment Law*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 102 (Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe eds., 2011).

<sup>2</sup> World Commission Environment and Development, *Report of the World Commission on Environment and Development: Our Common Future*, UN Doc A/42/427 (1987).

<sup>3</sup> *Id.* at overview ¶ 30.

<sup>4</sup> See MARIE CLAIRE CORDONIER SEGGER & ASHFAQ KHALFAN, SUSTAINABLE DEVELOPMENT LAW PRINCIPLES, PRACTICES & PROSPECTS 2-3 (2004).

<sup>5</sup> MARKUS W. GEHRING & MARIE CLAIRE CORDONIER SEGGER (EDS) SUSTAINABLE DEVELOPMENT IN WORLD TRADE LAW (2005).

<sup>6</sup> See generally Programme of Action for Sustainable Development, Report of the UNCED, U.N. GAOR, 46<sup>th</sup> Sess., Agenda Item 21, U.N Doc A/Conf.151/6/Rev.1 (1992), 31 I.L.M. 874 at ¶ 2.23; UN World Summit for Sustainable Development: Plan of Implementation, World Summit for Sustainable Development, UN Doc. A/CONF.199/L.1 (Johannesburg, South Africa 2002), Plan of Implementation of the World Summit on Sustainable Development, UN Doc. A/CONF.199/20 (2002) ¶ 4.

<sup>7</sup> Report of the Special Representative of the Secretary General on the Issue of Human Rights and Transnational Corporations and Other Business Entities UN doc. A/HRC/8/5 (April 1, 2008) at 3.

<sup>8</sup> Gus Van Harten, *A Critique of Investment Treaties*, in RETHINKING BILATERAL INVESTMENT TREATIES CRITICAL ISSUES AND POLICY CHOICES 41 (Kavaljit Singh & Burghard Ilge, eds., 2016).

<sup>9</sup> YVES DEZALAY & BRYANT GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER (1996).

<sup>10</sup> *Id.*

of litigation are thought up and supported by arbitrators will add to the need for States to rethink the system of investment arbitration.<sup>11</sup> Addressing this issue would require a comparison of the initial and the revised treaties' design and a systematic coding of their substantive provisions on various dimensions. This paper attempts to understand the present Indian international investment regime from a development perspective.

## II. *The Background of International Investment Agreements Reform*

In the last one decade, India's investment landscape has considerably changed. Foreign investment flows to India have also increased manifold from US\$393 million in 1992-93 to \$26192 million in the financial year 2011-12.<sup>12</sup> Increase in the number of IIAs coupled with increase in foreign investment flows has increased the interaction between different layers of governments, at the Centre and state levels, with foreign corporations belonging to one of the IIA partner countries of India and hence the possibility of a conflict due to the exercise of India's regulatory power.<sup>13</sup>

In fact, this past decade, treaty-based foreign investor arbitrations against host States have tripled, from just over 200 in 2005 to 668 in 2015,<sup>14</sup> marring the corresponding global surge in foreign direct investment from US\$11 trillion to US\$26 trillion.<sup>15</sup> The growing number of investor claims against sovereign States challenging a wide array of public policy decisions and regulatory measures has evoked deep concerns about the potential costs associated with such treaties.<sup>16</sup> To spot difficulties that could lead to investment disputes and allow for timely correction, governments are mapping and monitoring possible obstacles. They are also promoting an improved environment for IIAs in general by including more precise language and more specific exceptions in agreements to better reflect policy.<sup>17</sup>

No aspect of BIT practice has been more informative to governments than investor-state dispute settlement.<sup>18</sup> International treaties, like some domestic law, contain substantial ambiguities that are only clarified over time as the rules are implemented and enforced.<sup>19</sup> Rulings made by dispute settlement bodies interpret ambiguous or contested substantive provisions and thereby clarify their meaning and consequences.<sup>20</sup> Anne Van Aaken refers to the "learning effect" of BIT arbitration, which has caused states to approach them more cautiously.<sup>21</sup> Governments renegotiate when they have learned something new about the state of the world<sup>22</sup> or when the state of the world has actually changed.<sup>23</sup> Revising the Model BIT, India

<sup>11</sup> See Article 1 (1) (d) of the Canada China Treaty 2014.

<sup>12</sup> See Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, *FDI in India Statistics available at* [http://dipp.nic.in/English/Publications/FDI\\_Statistics/2012/india\\_FDI\\_January2012.pdf](http://dipp.nic.in/English/Publications/FDI_Statistics/2012/india_FDI_January2012.pdf).

<sup>13</sup> Prabash Ranjan, *Renegotiating India's Investment Agreements A Policy Perspective*, MADHAYM BRIEFING PAPER 7 (August 2012).

<sup>14</sup> Investment Dispute Settlement Negotiator, <http://investmentpolicyhub.unctad.org/ISDS>.

<sup>15</sup> World Investment Report, *Reforming International Investment Governance*, United Nations Conference on Trade and Development (2015).

<sup>16</sup> Lauge Skovgaard Poulsen & Emma Aisbett, *When the Claim Hits: Bilateral Investment Treaties and Bounded Rational Learning*, 65 (2) WORLD POLITICS 273-313 at 274 (2013).

<sup>17</sup> Kathryn Gordon & Joachim Pohl, *Investment Treaties Over Time: Treaty Practice and Interpretation in a Changing World* (OECD Working Papers on International Investment, 2015/02, 2015) available at <http://dx.doi.org/10.1787/5js7rhd8sq7h-en>.

<sup>18</sup> STEPHAN W SCHILL, *THE MULTILATERALIZATION OF INTERNATIONAL INVESTMENT LAW* (2009).

<sup>19</sup> Mark C. Suchman & Lauren B Edelman, *Legal Rational Myths: The New Institutionalism and the Law and Society Tradition*, 21 LAW AND SOCIAL INQUIRY 903-41 (1996).

<sup>20</sup> Judith Goldstein & Richard H Steinberg, *Negotiate or Litigate? Effects of WTO Judicial Delegation on U.S. Trade Politics*, 71 LAW AND CONTEMPORARY PROBLEMS 257-282 (2008).

<sup>21</sup> Anne Van Aaken, *International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis*, 12 (2) JOURNAL OF INTERNATIONAL ECONOMIC LAW 507-538 at 532 (2009).

<sup>22</sup> As a reaction to the decision in *Maffezini v. Kingdom of Spain*, the United States introduced a clause in some subsequent investment treaty negotiations aiming specifically at excluding the application of MFN Clauses to investor state dispute settlement. See Article 10.4 (2) footnote 1, Draft of the Central America-United States Free Trade Agreement (Jan. 28, 2004).

<sup>23</sup> Yoram Z. Haftel & Alexander Thompson, *When Do States Renegotiate International Agreements? The Case*

addresses issues related to overly broad interpretations of certain provisions by arbitral tribunals, to adequately reflect and take into account India's socio-economic policy realities.

### III. ISDS Claims Against India

This part discusses the major ISDS claims against India and analyses the reasons why India lost in *White Industries* and *Antrix Devas*.

#### (a) *White Industries*

In 1989, Coal India contracted White Industries Australia to supply mining machinery and develop a coalmine. Once the mine was in operation, a dispute arose between the two entities. In 1999, White Industries sought recourse from the International Chamber of Commerce Arbitration, and as there was a delay in the enforcement White Industries turned to the bilateral investment treaty between Australia and India.

Unfortunately for White Industries, there is nothing in the Australia-India BIT, which directly deals with the delays in the court system. White Industries found something suitable in the BIT between India and Kuwait under MFN, where India is required to maintain a favourable environment for Kuwaiti investors in India. The tribunal concluded that White Industries' rights under the ICC award were part of White Industries' original investment. This was because the ICC award crystallized the parties' rights and obligations under the contract. White Industries' rights under the award were therefore covered by the protection in the BIT and granted White Industries an award of over A\$4 million with interest, and related court fees.

#### (b) *Antrix Devas*

In 2005, the Indian Space Research Organization's (ISRO) commercial arm Antrix Corporation entered into an agreement<sup>24</sup> with Devas Multimedia to lease out satellite spectrum that Devas could use to provide high-quality telephony and Internet services. In 2011 however, a leaked draft audit report noted that there were potentially a number of irregularities in the agreement including conflict of interest, favouritism, financial mismanagement and non-compliance of standard operating procedures.<sup>25</sup> Then the deal was scrapped and the official reasons given for scrapping the deal was the *force majeure* event, and in this case it was the government acting in its sovereign capacity, deeming that the S-band spectrum needed to be used for national purposes and thus could not be leased out to Devas.<sup>26</sup> The second arbitration was filed by the company's investors, which include Columbia Capital and Telecom Ventures under the Indo-Mauritius Bilateral Investment Treaty. The Permanent Court of Arbitration ruled that the government's actions in 2011 amounted to expropriation and that in annulling the ISRO-Devas contract, the country has breached treaty commitments to accord fair and equitable treatment to Devas's foreign investors.<sup>27</sup> The first arbitration outcome, which was conducted by ICC, saw the Indian government receiving a fine of nearly \$672 million for unilaterally terminating the contract with Devas. The second, delivered by the Permanent Court of Arbitration makes it liable to pay financial compensation", with a minimum expected penalty of \$1 billion.<sup>28</sup>

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of Bilateral Investment Treaties (Nov. 15, 2013) (Submission to University of Maryland).

<sup>24</sup> "The deal involved *Antrix* committing to manufacturing and launching two ISRO satellites and then leasing nearly 70 MHz of S-band satellite spectrum to *Devas* for a period of 12 years. In return, *Devas* committed to paying upfront fees of a little over \$30 million".

<sup>25</sup> See the Report at [http://www.cag.gov.in/sites/default/files/audit\\_report\\_files/Union\\_Compliance\\_Scientific\\_Department\\_Multimedia\\_Broadcasting\\_Service\\_4\\_2012.pdf](http://www.cag.gov.in/sites/default/files/audit_report_files/Union_Compliance_Scientific_Department_Multimedia_Broadcasting_Service_4_2012.pdf).

<sup>26</sup> Anuj Srivas, *Explained: Why Does The Ghost Of Antrix-Devas Continue?* THE WIRE, July 27, 2016 at <http://thewire.in/54291/india-isro-arbitration-antrix-devas/>.

<sup>27</sup> See Anuj Srivas, *India Loses Big in Arbitration Case Over Antrix-Devas Controversy*, THE WIRE, July 26, 2016 at <http://thewire.in/53993/india-loses-big-in-arbitration-case-over-Antrix-Devas-Controversy/>.

<sup>28</sup> Prabash Ranjan, *Antrix-Devas: A BIT of Protectionism*, THE WIRE, Aug. 9, 2016 at <http://thewire.in/57586/antrix->

This annulment of the contract also resulted in another claim made under India-Germany BIT by Deutsche Telekom, the German telecom giant who invested \$100 million in Devas. This case is ongoing.<sup>29</sup>

(c) *Other Claims*

In June 2016, Cairn Energy, the Edinburgh-based oil firm, filed an arbitration claim under the previous India-UK BIT seeking \$5.6 billion in compensation from the Indian government for raising a retrospective tax demand of \$1.6 billion in 2014.<sup>30</sup>

Vodafone under the India-Netherlands BIT has made a similar claim. Vodafone, already disputing a US\$3 billion tax claim by the Indian Government, held that India's plan to retrospectively open tax cases was a breach of the country's BIT obligations and a denial of justice.<sup>31</sup>

Khaitan Holdings Mauritius Limited has sued India under the India- Mauritius BIT claiming \$ 1400 million in damages for the Supreme Court ordering the cancellation of the 2G licenses.<sup>32</sup>

A closer look at India's experience explains its move to redraft principal provisions in its model BIT text. India's worry is that the 89 international investment agreements it has signed render it highly vulnerable to expensive litigation,<sup>33</sup> in which disputants can often have, an unfair advantage. This is because India's agreements are based on age-old model text, which is no longer in keeping with today's realities.<sup>34</sup>

IV. *The Indian Model BIT 2015: A Developmental Analysis*

States need to ensure that private investor interests do not prevail over legitimate public concerns. At the same time host countries must ensure sufficient regulatory flexibility in their IIAs to pursue their domestic policy agendas. One means of achieving balance is to ensure that development concerns are adequately addressed throughout the agreement. Further adding investor responsibility provisions directly as part of IIAs is also important.<sup>35</sup> Therefore this part engages a developmental analysis of the Model BIT 2015.

(a) *Sustainable Development*

In the preamble, the Model BIT 2015 seeks to align the objectives of investment with sustainable development and inclusive growth of the parties. Further the Model BIT ensures that investments are in compliance with local laws and enhance their contribution to inclusive growth and sustainable development.<sup>36</sup> The terms "inclusive growth" and "sustainable development" are signs of "new generation" investment policies and the new Model BIT 2015 is a positive step to achieve sustainable development in India's investment treaty relations.

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devas-a-bit-of-protectionism/.

<sup>29</sup> *Id.*

<sup>30</sup> Ben Giaretta and Akshay Kishore, *The Changing Landscape of Investment Treaty Protection in India*, International Arbitration, April 2015.

<sup>31</sup> Premila Nazareth Satyanand, *Once BITten, Forever Shy: Explaining India's Rethink of Its Bilateral Investment Treaty Provisions*, 16 (1) AIB INSIGHTS 17 (2015).

<sup>32</sup> Prabash Ranjan, *Antrix-Devas: A BIT of Protectionism*, THE WIRE, Aug. 9, 2016 at <http://thewire.in/57586/antrix-devas-a-bit-of-protectionism/>.

<sup>33</sup> Kavaljit Singh, *India And Bilateral Investment Treaties — Are They Worth It?* FINANCIAL TIMES, Jan. 21, 2015.

<sup>34</sup> See generally James Nedumpara, *Imagining Space in India's Trade and Investment Agreements* (São Paulo Law School of Fundação Getulio Vargas — FGV DIREITO SP Research Paper Series — Legal Studies<sup>[1]</sup> Paper no. 113, 2014); Mihaela Papa, *Emerging Powers in International Dispute Settlement: From Legal Capacity Building to a Level Playing Field*, 3 (3) J. INT'L DISPUTE SETTLEMENT (2012).

<sup>35</sup> Anna Joubin-Bret, Marie-Estelle Rey & Jorg Weber, *International Investment Law and Development*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 24-25 (Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe eds., 2011).

<sup>36</sup> See Article 8.

(b) *Definition of Investment*

The jurisdiction of an arbitral tribunal and the applicability of the investment treaty are largely based on the definition of “investment”. Defining investment is not merely a legal issue but also involves policy considerations, as the way in which investment is understood reflects the system as a whole. In determining whether an activity is eligible for investment protection development considerations are inevitable.<sup>37</sup>

The 2003 Model was following a broad asset based definition of investment and the majority of Indian bilateral investment treaties incorporated the same except the India-Mexico one.<sup>38</sup> An open-ended definition of investment persuaded the tribunal in *White Industries* to conclude that a contract to provide own working capital, equipment and technical know-how and assumed financial risks for cost escalation and other penalties for inadequate performance, fell with the terms “right[s] to money or to any performance having a financial value”.<sup>39</sup> On the other hand the 2015 Model provides a narrow definition of “investment”. To claim protection under the new model BIT, an investor will have to have “real and substantial business operations” in India.<sup>40</sup> The narrow definition of investment is not an attempt to regulate foreign investments. A simple reading may make people think that the enterprise-based definition may be an attempt to regulate the foreign investment. A reading further clarifies the objective as bringing equilibrium between the investment treaties and the regulatory power of the host States.<sup>41</sup>

In the same line the narrow definition of government refers only the actions of central government.<sup>42</sup> Many of the IIA cases stem from conflicts with subnational bodies.<sup>43</sup> A procedural problem that often arises is that different bodies may give different signals in relation to an investment project, one giving favourable expectations to the concerned parties while the other indicates otherwise.<sup>44</sup> The narrow definition of government may bring sustainability regarding these issues.

(c) *Most Favoured Nation (Omitted)*

A very broad application of MFN provisions is very common in the Indian BITs.<sup>45</sup> In many cases MFN allowed the investor to “cherry-pick” more favourable provisions from third-country BITs without being bound to any less favourable conditions contained in those treaties.<sup>46</sup> The technique is a departure from existing international law.<sup>47</sup>

The use of provisions of another unconnected treaty goes well beyond the construction of consent that is involved when jurisdiction is claimed on the basis of an investment treaty. It seeks to link the consent in an entirely unrelated treaty to the foreign investor when there is no logical chain that connects the two

<sup>37</sup> Marek Jezewski, *Development Considerations in Defining Investment*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 215 (Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe eds., 2011).

<sup>38</sup> Prabhash Ranjan, *India and Bilateral Investment Treaties — A Changing Landscape*, 29 ICSID REVIEW 2 — FOREIGN INVESTMENT LAW JOURNAL, 420, 419-450 (2014).

<sup>39</sup> See *White Industries Arbitration Award* ¶ 7.4.10.

<sup>40</sup> “It must have made a long- term commitment to India in terms of capital, employees and transfer of know-how, and cannot just be holding Indian assets”.

<sup>41</sup> Prabhash Ranjan, *A BIT of an Overreaction*, THE FINANCIAL EXPRESS, Apr. 4, 2015.

<sup>42</sup> “In some respects, the actions of state governments are covered by the BIT, but not those of local governments”.

<sup>43</sup> See generally *Metalclad Corp. v. Mexico*, Award of 30 August 2000, 5 ICSID Reports (2002) 209; *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, Award of 29 May 2003, 43 ILM (2004) 133.

<sup>44</sup> See generally *MTD v. Chile*; *Maffezini v. Spain*.

<sup>45</sup> See Biswajit Dhar, Reji Joseph, T C James, *India’s Bilateral Investment Agreements: Time to Review*, XLVII (52), ECONOMIC AND POLITICAL WEEKLY, <http://www.epw.in/special-articles/indias-bilateral-investment-agreements.html>.

<sup>46</sup> See generally *Siemens v. Argentina*, Decision on Jurisdiction, August 3, 2004, ¶ 32-110; *Emilio Augustin Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7; *White Industries Australia Ltd. v. Republic of India*, UNCITRAL; *AAPL v. Sri Lanka*, ICSID Case No. ARB/87/3; *Pope & Talbot v. Canada*, UNCITRAL, 31 May 2002.

<sup>47</sup> *Impregilo SpA v. The Argentine Republic*, ICSID Case No ARB/07/17, Concurring and dissenting opinion of prof. Brigitte Stern, 21 June 2011.



treaties. Studies show that the wording of the treaties does not have such effect.<sup>48</sup> The wording of many MFN clauses did not suggest that they applied to dispute settlement and while interpreting MFN particular care should nevertheless be exercised in ascertaining the intentions of the parties with regard to an arbitration agreement which is to be reached by incorporation by reference in an MFN clause.<sup>49</sup> Broad interpretations will result in treaty shopping which is highly undesirable since the goal of investment treaty law is to foster sustainable economic relationships between States.

(d) *Fair and Equitable Treatment (Omitted)*

The absence of a clear explanation of what is fair and what is equitable has led to a great variety of claims against host State regulations. It also raises fears that FET provision in IIAs threatens policy space and progress that has been made in promoting sustainable development. Such fears are intensified by the lack of legal certainty with respect to the application of fair and equitable treatment and the concrete scope of the standards sub elements such as fair procedure, non-discrimination, protection of investor's legitimate expectations, transparency and proportionality.<sup>50</sup> There is also a possibility that any attempt to reform policies, which affect foreign investors interests could be argued as undermining the stability of law and business, leading to its being ruled incompatible with IIAs. Interpretations that overemphasize stability may be inconsistent with the promotion of sustainable development.<sup>51</sup>

FET is omitted in the Model BIT 2015; however, the duty to afford due process and the protection is granted against manifestly abusive treatment or targeted discrimination on manifestly unjust grounds or denial of justice in any judicial or administrative proceedings.<sup>52</sup>

(e) *Investor and Home State Obligations*

The Model BIT indicates a change in course on the part of the Government. After delineating India's duty to protect investors and their investments, India's model text also places responsibilities on both investors and their home States to ensure responsible corporate conduct and inclusive and sustainable growth in its territory.<sup>53</sup> The Model BIT requires foreign investors to contribute to the development of the host State and to operate by recognizing the rights, traditions and customs of local communities in order to obtain treaty benefits. Investors are also required to make long-term commitments, hire local employees, avoid corruption, be transparent about financial transactions and governance mechanisms, and comply with host State taxation policies. Signatory home States are required to act against investors found to be violating Indian laws.<sup>54</sup> Host countries could initiate counterclaims in international arbitration for any violations of obligations on foreign investors. This is a mechanism to promote sustainable development using IIAs. It is accepted that host States could bring sustainability through direct regulations and investor obligations.<sup>55</sup>

<sup>48</sup> See generally Julie Maupin, *MFN Based Jurisdiction In Investor State Arbitration: Is There Any Hope For A Consistent Approach?* 14 JOURNAL OF INTERNATIONAL ECONOMIC LAW 157 (2011); Zachary Douglas, *The MFN Clause In Investment Treaty Arbitration: Treaty Interpretation Off The Rails*, 2 JOURNAL OF INTERNATIONAL DISPUTE SETTLEMENT 97 (2011).

<sup>49</sup> See generally *Telenor v. Hungary*, ICSID Case No. ARB/04/15; *Plama v. Bulgaria*, ICSID Case No. ARB/03/24; *Berschader v. Russia*, SCC Case No. 080/2004.

<sup>50</sup> Roland Klager, *Fair and Equitable Treatment and Sustainable Development*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 237 (Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe eds., 2011).

<sup>51</sup> Kate Miles, *Sustainable Development, National Treatment & Like Circumstances in Investment Law*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW 261 (Marie-Claire Cordonier Segger, Markus W Gehring & Andrew Newcombe eds., 2011).

<sup>52</sup> See Article 3.

<sup>53</sup> Kavaljit Singh, *Decoding India's New Model BIT*, Madhyam 2015.

<sup>54</sup> Premila Nazareth Satyanand, *Once BITten, Forever Shy: Explaining India's Rethink of Its Bilateral Investment Treaty Provisions*<sup>[SEP]</sup>, 16 (1) AIB INSIGHTS 17 (2015).

<sup>55</sup> Non-State Actors and Human Rights (Philip Alston, ed., 2005).

(f) *Exhaustion of Local Remedies Requirement*

Modern investment treaties habitually grant investors the right to bring a claim against the host State directly before an international arbitral tribunal. The direct standing of foreign investors in investment law is thus mainly motivated by the ineffectiveness of the traditional system of diplomatic protection, which not only requires the exhaustion of all local remedies,<sup>56</sup> but more importantly is a discretionary right of a State only.<sup>57</sup> The direct access to arbitration on the contrary provides a guarantee for the investor to have access to an effective international remedy<sup>58</sup> while at the same time offering an interesting investor friendly environment for the host State.<sup>59</sup>

Customarily, conflicts between individuals and a State in the exercise of its sovereign authority can be brought only before the domestic courts of that State, since the application of State immunity would prevent the submission of such claims to the domestic courts of the individual's home State. The direct access to arbitration is by no means intended to be a generalized claims procedure to deal with any type of dispute between host State and the foreign investor. States grants the access of foreign investors to arbitration only through the explicit consent, as is the case in general international law.<sup>60</sup> Access to investment treaty arbitration may be restricted by the consent of the State.<sup>61</sup> States, when expressing consent to direct investment arbitration, may condition their consent and for example require foreign investors to exhaust local remedies, either generally or for a limited time period.<sup>62</sup> The obvious intention behind these measures is that a good faith effort at solving the dispute through domestic means should first have been attempted before recourse to international means of settlement. But claimants have often ignored these prescriptions, and the practice of tribunals has been to condone the failure to have recourse to negotiations for the specified period, usually on the ground that such negotiations are not mandatory.<sup>63</sup>

The grant of substantive rights to foreign investors is fundamentally different from the access to investment arbitration. The mere fact that contemporary investment treaties contain standards of treatment that create right to investment protection does not in and of itself create a right to initiate a claim for alleged breaches of these rights directly against the host State.<sup>64</sup> The exhaustion of local remedies requirement is an admissibility requirement for the exercise of the State's right to diplomatic protection; it does not affect the existence of the right of States to initiate claims as such.<sup>65</sup> Since the objective of these treaties is not the

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<sup>56</sup> International Law Commission, Draft Articles on Diplomatic Protection, Report on the Work of Its 58<sup>th</sup> Session (1 May- 9 June and 3 July- 11 August, 2006) General Assembly Official Records, 61<sup>st</sup> Session, Supplement No 10, UN Doc A/61/10, 2006, p. 26.

<sup>57</sup> *See generally* Mavrommatis Palestine Concession ("The state of the individual's nationality is not acting in the rights of the individual, but is acting in its own rights, namely the right to see the law respected for its nationals"); Barcelona traction ("The individual has no right of diplomatic protection and is dependent on the political discretion of the government").

<sup>58</sup> "It is claimed that investment treaties replace domestic law and courts with a fair, independent, and neutral process of adjudication to resolve investor-state disputes and that the system therefore advances the rule of law".

<sup>59</sup> *See contra* Gus Van Harten, *A Critique of Investment Treaties*, in *RETHINKING BILATERAL INVESTMENT TREATIES CRITICAL ISSUES AND POLICY CHOICES* 41 (Kavaljit Singh & Burghard Ilge, eds., 2016) (Harrten criticizes investment treaty arbitration on the following grounds (i) only private investors are given the right to be heard; (ii) institutional safeguards of independence are lacking; (iii) decision making on public law matters by private arbitrators who are typically technocrats, intent on promoting the arbitration industry in competition with its alternatives; and (iv) no security of tenure for arbitrators which is one of the core safeguards of adjudicative independence in public law).

<sup>60</sup> *Garanti Koza LLP v. Turkmenistan*, ICSID Case No. ARB/11/20, Decision on the Objection to Jurisdiction for Lack of Consent, 2 July 2013. *See the dissenting opinion of arbitrator Laurence Boisson de Chazournes*, ¶ 5.

<sup>61</sup> ICJ, *Certain Questions of Mutual Assistance in Criminal Matters, Djibouti v. France*, ICJ reports 2008, 177 at 203 ¶ 60.

<sup>62</sup> RUDOLF DOLZER AND CHRISTOPHER SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 214-26 (2008).

<sup>63</sup> *See generally* *Belgium v. Senegal Questions Relating to the Obligation to Prosecute or Extradite*, ICJ Judgment General List No 144 (2012); Samuel Worthsone, *Jurisdiction, Admissibility And Preconditions to Arbitration*, 27 ICSID REVIEW 255 (2012).

<sup>64</sup> *See Impregilo SpA v. The Argentine Republic*, ICSID Case No ARB/07/17, Concurring and Dissenting Opinion of Prof. Brigitte Stern, 21 June 2011 ¶ 53.

<sup>65</sup> *See generally* Articles 26 and 27 of ICSID Convention.

settlement of private disputes between foreign investors and host States, but rather to strengthen economic relations, promote foreign investment and the general development of State's economies, investor access to investment treaty arbitration needs to be seen as an element in achieving these objectives. Direct access to international arbitration causes detrimental impact on the development of rule of law as it creates disincentives for the domestic legal system to develop.<sup>66</sup>

There is a need to revive the exhaustion of remedies rule and state a category of non-arbitrable disputes with greater precision.<sup>67</sup> The respondent State must be put in a position to redress the wrongdoings of its judiciary. In other words, it cannot be held liable unless the system as a whole has been tested and the initial *delict* remained uncorrected.<sup>68</sup> Local courts first requirements have often been deemed to constitute merely waiting periods, which do not pose an obstacle to the jurisdiction of an investment tribunal.<sup>69</sup> Exhaustion of local remedies can be considered a concession to the sovereign independence of the host State, which should be presumed capable of rendering justice through its own courts.<sup>70</sup> The requirement would put pressure on national courts to adjudicate quickly and efficiently.<sup>71</sup> Furthermore due process might be adhered to if national courts know that their decision might come before an international tribunal.<sup>72</sup> This would also allow for preliminary injunctions on the domestic plane. Further the victims cannot approach the international arbitration tribunal against the foreign investor for violation of their human rights. Providing effective domestic remedies in cases where actual violations have occurred could bring in sustainability.<sup>73</sup>

From the point of view of the investor, the investor-State arbitration mechanism appears biased against small and medium-size investors.<sup>74</sup> The additional burden of exhausting local remedies can deter such firms from pursuing arbitration.<sup>75</sup>

The most likely and most efficient way forward is a combination of the national and international levels in the use of remedies. This combination allows primary remedies to be sought and also they take care of the need to settle cases quickly.<sup>76</sup> The Model BIT recognizes the fundamental principle of exhaustion of local remedies.<sup>77</sup> The model merely strengthens the rule by making it mandatory for the investor to litigate the claim before domestic courts for a minimum period of five years.<sup>78</sup> If investment arbitrations were proceedings whereby the investor were acting on behalf of the home State, it appears logical that the State parties to the treaties would insist upon the exhaustion of local remedies.<sup>79</sup>

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<sup>66</sup> See Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 INT'L REV. LAW & ECON (2005) 107 at 108.

<sup>67</sup> See *Desert Line v. Yemen*, ICSID Case No. ARB/05/17.

<sup>68</sup> See *Jan de Nul v. Egypt*, ICSID Case No. ARB/04/13.

<sup>69</sup> See *Wintershall v. Argentina*, ICSID Case No. ARB/04/14 ¶ 74, 115.

<sup>70</sup> See C AMERASINGHE, *LOCAL REMEDIES IN INTERNATIONAL LAW* 61 (2004).

<sup>71</sup> See Rudolf Dolzer, *The Impact Of International Investment Treaties On Domestic Administrative Law*, 37 NYU JILP 953, 970 (2005).

<sup>72</sup> See R H Mnookin & L A Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L J 950 (1979).

<sup>73</sup> John Ruggie, *State Responsibility to Regulate and Adjudicate Corporate Activities under the United Nations Core Human Rights Treaties* (2007).

<sup>74</sup> Srividya Jandhyala & Robert J. Weiner, *Institutions Sans Frontières: International Agreements and Foreign Investment*, 45 JOURNAL OF INTERNATIONAL BUSINESS STUDIES 649-669 (2014).

<sup>75</sup> Srividya Jandhyala, *Bringing the state back in: India's 2015 model BIT*, Columbia FDI Perspectives, No. 154, August 17, 2015.

<sup>76</sup> See Jacomijn J Van Haersolte- Van Hof & Anne K Hoffmann, *The Relationship Between International Tribunals And Domestic Courts*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 962, 1000 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

<sup>77</sup> It is significant to note that the principle of exhaustion of local remedies exists in other branches of international law such as in human rights treaties.

<sup>78</sup> Saurabh Garg, Ishita G. Tripathy and Sudhanshu Roy, *The Indian Model Bilateral Investment Treaty: Continuity and Change*, in RETHINKING BILATERAL INVESTMENT TREATIES: CRITICAL ISSUES AND POLICY CHOICES 69 (Kavaljit Singh & Burghard Ilge, eds., 2016).

<sup>79</sup> See Jacomijn J Van Haersolte- Van Hof & Anne K Hoffmann, *The Relationship Between International Tribunals And Domestic Courts*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 962, 1000 (Peter

(g) *Other Observations*

India is taking a more protectionist stand under the new Model BIT by providing for excluded areas.<sup>80</sup> Further, an arbitration tribunal is not given powers to re-examine any judicial decisions. It also contains expansive provisions to make the ISDS more transparent and accountable as good governance initiatives.<sup>81</sup> To ensure arbitrators are impartial and free of any conflict of interest, detailed disclosure norms and codes of conduct for arbitrators have been introduced. Retaining the ISDS system demonstrates a continued commitment to settle disputes in accordance with international law. Attempts have been made to strike a balance between the costs and benefits of ISDS. From an Indian perspective, investments treaties are not just instruments of investor protection, but also a valid tool promoting sustainable development goals, ensuring transparency in corporate dealings and preventing unethical business practices.<sup>82</sup>

V. *Conclusion*

Having a strong and predictable ISDS management framework brings sustainability in providing a more effective response to investment disputes, and may even serve as a deterrent to claims as investors assess the option of international investment arbitration.<sup>83</sup> Uniform rules of investment protection saves transaction costs in the drafting of BITs,<sup>84</sup> stabilizes the economy, reduces international conflicts and provides legal security to investors as well. The use of model treaties did not only serve the purpose of facilitating the negotiations about the content of a BIT and thus of reducing the drafting and negotiation costs. It also aimed at ensuring a certain level of uniformity with respect to the standards governing the investment relations between the home State and varying host States and to make more credible commitments with respect to foreign investors.<sup>85</sup> The current reforms in BIT including on most disputed provisions in International Investment Arbitrations would create more stable investment regime and minimize misuse of ISDS mechanism.<sup>86</sup> Reforming the regime is a gradual process, and the Model BIT is obviously an important step to integrate sustainable development concerns in the investment treaty system.

Though the reform is in a positive direction, there are many issues yet to be clarified. For bringing clarity and sustainability in international investment agreements UNCITRAL could take initiatives to help the developing economies especially for doing a sustainable impact assessment of the international investment agreements. Transparency may be given special attention to ensure that interests of everyone are effectively taken care of for sustainable development in international investment relations.

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Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

<sup>80</sup> The Government has reserved the right to take action protecting public health, safety or the environment, without contravening foreign investors' rights. Further suggested that the following (among other matters) are also not covered: □ intellectual property rights; contracts with the Government; court judgments and arbitral awards; and taxation. See the Model BIT 2015.

<sup>81</sup> See generally UN World Summit for Sustainable Development: Plan of Implementation, World Summit for Sustainable Development, UN Doc. A/CONF.199/L.1 (Johannesburg, South Africa 2002), Plan of Implementation of the World Summit on Sustainable Development, UN Doc. A/CONF.199/20 (2002) ¶ 4; Principle 6, New Delhi Declaration on the Principles of International Law Related to Sustainable Development (London: ILA, 2002); Monterrey Consensus of the International Conference on Financing for Development, Report of the International Conference on Financing for Development, UN Doc. A/CONF.198/11 (22 March 2002) Ch.1, Resolution 1, annex (2002) ¶ 21.

<sup>82</sup> UNCTAD Expert Meeting on Taking Stock of IIA Reform, *Indian Model Bilateral Investment Treaty* (Geneva, 16 March 2016).

<sup>83</sup> Kathryn Gordon & Joachim Pohl, *Investment Treaties Over Time: Treaty Practice and Interpretation in a Changing World* (OECD Working Papers on International Investment, 2015/02, 2015) available at <http://dx.doi.org/10.1787/5js7rhd8sq7h-en>.

<sup>84</sup> Kennedy, *A WTO Agreement on Investment: A Solution in Search of a Problem?* 24 U. PA. J. INT'L ECON. L. 77, 79-80 (2003).

<sup>85</sup> Stephan W. Schill, *The Multilateralization of International Investment Law* 91 (2009).

<sup>86</sup> UNCTAD Expert Meeting on Taking Stock of IIA Reform, *Indian Model Bilateral Investment Treaty* (Geneva, 16 March 2016).

## *Judicial Response to International Commercial Arbitration with Specific Reference to Venue of Arbitration: Need for Protection of Investors' Interest*

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"I realized that the true function of a lawyer is to unite the parties involved in a dispute. The lesson was so indelibly burnt into me that the large part of my time during the twenty years of my practice as a lawyer was occupied in bringing about private compromises of hundreds of cases. I lost nothing, there by not even money and certainly not my soul."

Mahatma Gandhi<sup>1</sup>

In 1991, India decided for liberalization and globalization by providing its investors a market oriented economy. There was unprecedented growth that resulted in a surge in trade and investments.<sup>2</sup> It is believed that there is a close nexus between trade and development.<sup>3</sup> One of the inevitable consequences of these commercial activities is, of course, the growth of cross border disputes involving multinational corporations and sovereign states.<sup>4</sup> In international trade and commerce, parties come from different states having different legal and cultural background. So in order to avoid legal disputes, their every commercial activity is preceded by a contract fixing the obligations of the parties.<sup>5</sup>

The Indian judiciary is determined to keep a close watch on the practice of international arbitration in the country and perform its role of a guardian to promote and encourage speedy, neutral, effective arbitration proceedings and enforcement of award in the country. India is all set to take on the world arbitration market with its best foot forward.<sup>6</sup> Since, national court of one party is foreign court to other party; it is preferred to have acceptance of arbitration as the most favourable method for resolving cross-border commercial disputes.<sup>7</sup> Arbitration provides a mechanism or process to the contracting parties by which disagreements are submitted to the arbitral tribunal which are appointed and trusted by the parties.<sup>8</sup> International Commercial Arbitration is termed as 'international' not because sovereign nations participate, but because the parties, the facts, or the legal effects of the dispute extend beyond a single jurisdiction.<sup>9</sup> Courts should be cautious of intervening during a foreign arbitration proceeding is that the benefits in efficiency, cost, confidentiality, and reduced complexity of the arbitration process diminish.<sup>10</sup> In order, to protect the foreign investors the Arbitration and Conciliation Act, 1996 (herein after 1996 Act) provides for international perspective, based on UNCITRAL Model Law, 1985. This Act is later amended in 2015.

The author looks into:

- development of international arbitration in India, in New York and Geneva Convention, and in UNCITRAL rules;

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<sup>1</sup> Pallab Das, *Arbitration : An Alternate To Litigation* THE LIBERTATEM MAGAZINE (Dec. 27, 2016) <http://mylibertatem.com/arbitration-an-alternate-to-litigation-2/>.

<sup>2</sup> Harisankar KS *Contemporary International Arbitration In Asia: A Stock Take* IJAL III(1) retrieved from [http://www.ijal.in/sites/default/files/IJAL%20Volume%203\\_Issue%201\\_Harisankar%20KS.pdf](http://www.ijal.in/sites/default/files/IJAL%20Volume%203_Issue%201_Harisankar%20KS.pdf).

<sup>3</sup> R. Usharani, *Recent Trends in International Commercial Arbitration*, 2007(5) KAR.LJ 33-39

<sup>4</sup> Harisankar KS, *supra* note 2.

<sup>5</sup> Sabyasachi Chatterjee, *Law applicable to International Commercial Arbitration*, 2004(4) JSLC 109-116.

<sup>6</sup> Yogesh Pratap Singh, Nachiketa Mittal, *Making Indian Arbitration Popular*, THE STATESMAN, (December 29, 2016) retrieved from <http://www.thestatesman.com/features/making-indian-arbitration-popular-1482974325.html>.

<sup>7</sup> MARGARET L. MOSES, *THE PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 1 (Cambridge University Press, 2008).

<sup>8</sup> Neeraj Tiwari, *Critical issues in International Commercial Arbitration*, 2012(4) Arb. LR 18-24(JS).

<sup>9</sup> Ole Lando, *The Lex Mercatoria in International Commercial Arbitration*, 34 ICLQ 747, 1985 (referred from Jeevan Krishna, *Law of Choice in International Commercial Arbitration*, 20(1&2) Academy Law Review 61-78).

<sup>10</sup> Sandeep S. Sood, *Finding Harmony with Uncitral Model Law: Contemporary Issues in International Commercial Arbitration in India after the Arbitration And Conciliation Act of 1996* available at [http://works.bepress.com/sandeep\\_sood/2/](http://works.bepress.com/sandeep_sood/2/).

- Judicial Response to International Commercial Arbitration;
- Problems faced by the parties and how far are the interest of parties secured.

### *Development of International Arbitration in India*

International Commercial Arbitration, which is a sprout of arbitration<sup>11</sup>, has evolved as private transnational system of dispute resolution comprising of bilateral treaties, multilateral conventions, national arbitration laws, and norms of arbitral institutions. In India, three Acts that governed the law of Arbitration are:

- The Arbitration (Protocol and Convention) Act, 1937, which gave effect to the Geneva Convention;
- The Arbitration Act, 1940, which dealt with domestic awards,
- The Foreign Awards (Recognition and Enforcement) Act, 1961 which gave effect to the New York Convention of 1958.

After Independence, the mandate under Article 51, Constitution of India, 1950 provides that “the State shall encourage settlement of international disputes by arbitration”. The 1996 Act is drafted in line with the Model Law on International Commercial Arbitration. It has been adopted by United Nations Commission on International Trade Law (UNCITRAL) in 1985 to establish a unified legal framework for the fair and efficient settlement of disputes arising in international commercial relations. The Act seeks not only to consolidate but also to unify Indian law both on domestic and international arbitration.<sup>12</sup> The Act is divided in four parts: Part I deals with domestic arbitration including International Commercial Arbitration conducted in India, Part II deals with enforcement of foreign awards governed under New York and Geneva Convention, Part III and IV deals with conciliation and supplementary rules. The paper will focus on Part I and II.

Also, Indian Council of Arbitration was established in 1965. It keeps contact with important arbitral associations, experts and distinguished persons of different countries. The Council collects information about rules of Indian and foreign arbitral institutions and circulates the journal worldwide. It also organizes a program for the exchange of panels with other arbitral institutions.<sup>13</sup>

### *International Commercial Arbitration in India*

Section 2(1)(f) defines “international commercial arbitration” as an arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is—

- (i) an individual who is a national of, or habitually resident in, any country other than India; or
- (ii) a body corporate which is incorporated in any country other than India; or
- (iii) an association or a body of individuals whose central management and control is exercised in any country other than India; or
- (iv) the Government of a foreign country.

<sup>11</sup> P.T. Kamala Priya and S. Karpaga Priya, International Commercial Arbitration — A New Dimension (Mad.LJ Vol. 203 13).

<sup>12</sup> A. Jayagovind, International Commercial Arbitration under the Arbitration and Conciliation Act, 1996 (IJIL 1997 VOL. 37 658-672).

<sup>13</sup> Ernest J. Cohn & Martin Domke (et.al) Handbook Of Institutional Arbitration (North Holland Publishing Company Amsterdam 1977 pg.99).

This definition develops consonance with Model Law<sup>14</sup>. Article 1 (3) broadens the notion of internationality and covers cases where the place of arbitration, the place of contract performance, or the place of the subject-matter of the dispute is situated outside the State where the parties have their place of business, or cases where the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.<sup>15</sup> UNCITRAL focus upon place of business, whereas 1996 Act is about nationality.

Also, in 1996 Act the word ‘commercial’ covers legal relations whether contractual or not. UNCITRAL defines ‘commercial’ and both take similar approaches but are slightly divergent in practicality.<sup>16</sup> This empowers the Court to broaden or narrow the definition. In civil law countries, business and commercial have different meanings but not in other countries.<sup>17</sup> The territorial criterion is of considerable practical importance in Articles 11, 13, 14, 16, 27 and 34 which entrust State courts at the place of arbitration with functions of supervision and assistance to arbitration.<sup>18</sup>

### *New York Convention*

New York Convention, also known as the Recognition and Enforcement of Foreign Arbitral Awards, is one of the most important and successful United Nations treaties in the area of international trade law.<sup>19</sup> Till date 156 States are signatory to this Convention.<sup>20</sup> Its application requires firstly, one of the party must be from signatory country; secondly transaction is ‘commercial’ in nature. The word ‘commercial’ is defined in Model Law<sup>21</sup> but not in New York and Geneva Convention. It is left to national courts to define it.<sup>22</sup>

Also, to see whether the prospective forum recognizes and enforces awards rendered at the place of arbitration. The jurisdiction of court to refer to arbitration arises when it is seized of an action unless agreement is null and void, inoperative or incapable of being performed.<sup>23</sup> The party must recognize where the defaulting party has the assets in different countries and to go for ‘forum shopping’. It requires understanding of other factors also like adherence of that country to this Convention or attitude of Courts or the law of that State.

New York Convention does not provide any time limit for refusal to recognition and enforcement. However, Part I, 1996 Act provides three months period to set aside the award and further, thirty days maximum on sufficient cause only.<sup>24</sup>

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<sup>14</sup> Article 1 (3), Model Law defines an arbitration is international if:

- (a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or
- (b) one of the following places is situated outside the State in which the parties have their places of business:
  - (i) the place of arbitration if determined in, or pursuant to, arbitration agreement;
  - (ii) any place where a substantial part of the obligations of commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or
- (c) the parties have expressly agreed that the subject matter of arbitration agreement relates to more than one country.

<sup>15</sup> UNCITRAL Model Law on International Commercial Arbitration, 1985 with amendments as adopted in 2006, UNITED NATIONS, Vienna, 2008.

<sup>16</sup> Harsh Sethi and Arpan Kr Gupta International Commercial Arbitration & its Indian Perspective (Universal Law Publishing, New Delhi pg. 20 2011).

<sup>17</sup> Nigel Blackaby and Constatine Partasides (et.al), Redfern and Hunter on International Arbitration Oxford University Press 14 2015.

<sup>18</sup> UNCITRAL, 1985.

<sup>19</sup> [http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/2016\\_Guide\\_on\\_the\\_Convention.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/2016_Guide_on_the_Convention.pdf).

<sup>20</sup> [www.newyorkconvention/countries](http://www.newyorkconvention/countries) as on January 6, 2017

<sup>21</sup> Srishti Jha, Implications of the Term ‘Commercial’ in International Commercial Arbitration (2001) 40 CLA 36.

<sup>22</sup> Julian D M Lew QC and Loukas A Minstelis (et.al) Comparative International Commercial Arbitration (Wolters Kluwer 2007 1st edn. Indian reprint 55).

<sup>23</sup> Article II(3).

<sup>24</sup> Section 34.

In New York Convention, recognition and enforcement are used interchangeably and interlinked but not in Geneva Convention. ‘Recognition’ is to demand remedy on previous arbitral proceedings, whereas, ‘enforcement’ means to recognize legal force and effect the award and to ensure that it is carried out by using such legal sanctions.<sup>25</sup> It deals with challenges made on foreign awards.<sup>26</sup> It is developed to provide uniformity in recognition and enforcement. UNCITRAL is closely modelled on this Convention, though similar points are included for recognition and enforcement<sup>27</sup> but are differently interpreted in Courts.<sup>28</sup>

New York Convention gives discretion to the judges to decline the enforcement of foreign award on grounds, such as award has been set aside in the country where it made whether the cause of annulment is also recognized by the law of the enforcement forum or not.<sup>29</sup> Article V (1) (e) allows court to exercise jurisdiction on enforcement but it cannot set aside the award; whereas, domestic award can be set aside.

### *Geneva Convention*

Geneva Convention, 1927 requires that both or all the parties must belong to two different signatory states.<sup>30</sup> Article II provides exhaustive list of refusal and obliges courts to enforce foreign awards unless it is proven that they comport at least one of the limited number of refusal.<sup>31</sup> As there is limited applicability of the Convention and understandable reluctance of judges to enforce awards that have been rejected in their countries of origin, the practical rule is to give due consideration to the Arbitration laws of the contracting parties.<sup>32</sup>

The Convention will be called foreign award whenever it is ‘commercial’ under 1996 Act and both the parties are from signatory states. However, the Convention will not be applicable in cases the award is made in India.<sup>33</sup> Also, this convention is replaced by New York Convention when both the States are signatory to both the Conventions.<sup>34</sup>

### *UNCITRAL 1985*

According to Model Law 1985, place of arbitration is the place of contract performance, or the place of the subject-matter of the dispute is situated outside the State where the parties have their place of business, or cases where the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country. The applicable law and the applicable procedure have different meanings; the former implies the law chosen to regulate the contract and the latter is the law in the arbitration agreement.<sup>35</sup>

- Article 1 recognizes extensively the freedom of the parties to submit a dispute to the legal regime established pursuant to the Model Law.
- Article 19 and 28 provides about applicable law
- Article 15 and 33 discusses rules of procedure.

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<sup>25</sup> See Nigel Blackaby, *supra* note 17.

<sup>26</sup> *Union of India Vs. Reliance Industries Limited* (2015(10) SCALE149).

<sup>27</sup> Article 36, UNCITRAL Model Law and Article V, New York Convention.

<sup>28</sup> See Nigel Blackaby, *supra* note 17.

<sup>29</sup> Ronald Bernstein, *Handbook of Arbitration Practice* (Sweet & Maxwell with The Chartered Institute of Arbitrators, London 1993 446).

<sup>30</sup> C. R. DATTA, *LAW RELATING TO COMMERCIAL & DOMESTIC ARBITRATION* (1st ed., Wadhwa & Co’, Nagpur., 2008).

<sup>31</sup> See the contra view to Article II in Ronald Bernstein (*supra* note 29), (an award does not become defective because it has been rendered defective by their court itself).

<sup>32</sup> See Ronald Bernstein, *supra* note 29.

<sup>33</sup> See C. R. Datta, *supra* note 30.

<sup>34</sup> *Renusagar Power Co’ Ltd. v. General Electric Co’*, AIR 1994 SC 860.

<sup>35</sup> MINABERE TOM- GEORGE, *INTERNATIONAL COMMERCIAL ARBITRATION* (38 Sheriden Book Co. New Delhi 1996).



The Commission<sup>36</sup> agreed to clarify that the “determination of the place” of arbitration had legal consequences<sup>37</sup>. Also, it should include that it will lead to determination of the court competent with respect to the arbitral proceedings.

The Commission also suggested that it is the need of the hour for the parties and arbitral tribunal to expand their knowledge and familiarize themselves with not only the “law” on arbitration and any other relevant procedural law but also “practice” and “enforcement” law that did not receive support.<sup>38</sup>

In para. 31, it is agreed that the parties and the arbitral tribunal should consider that holding all hearings outside of the place of arbitration might have an impact at the stage of judicial review, setting aside or enforcement of the arbitral award in certain jurisdictions.<sup>39</sup>

### *Choice of Place*

There is a freedom of choice in the law governing international arbitration.<sup>40</sup> When the contract is governed by the law of place then contract is subject to the jurisdiction; When the parties choose arbitral institution then their rules will apply; When the parties choose national arbitration law of a place of then applicable law and procedural law will be of arbitration of that place; When the parties choose venue for arbitration then arbitration is subject to law of arbitration of that place (*lex loci arbitri*).<sup>41</sup> The geographical location is of great importance and affects more mundane matters including logical functioning in arbitration.<sup>42</sup>

When express agreement doesn’t exist, presumption is that the parties intend the curial law (procedural law or *lex fori*)<sup>43</sup> to be the law of the ‘seat of arbitration’.<sup>44</sup> The ‘proper law’ implies law by which parties intended to be governed and when intention is not express or implied or inferred from circumstances then law with which there is closest and most real connection.<sup>45</sup>

### *Importance of Seat*

The seat of arbitration (also called place of arbitration) refers to the legal rather than physical location of the arbitration, whereas ‘venue’ is where the hearing physically takes place.<sup>46</sup>

While choosing the place, the parties must understand the consonance between “seat of arbitration” and the “Forum where arbitration is sought” and look at:

<sup>36</sup> Report of Working Group II (Arbitration and Conciliation) on the work of its sixty-fourth session (New York, 1-5 February 2016), United Nations Commission on International Trade Law Forty-ninth session, New York, 27 June-15 July 2016, General Assembly, United Nations.

<sup>37</sup> Para. 28, UNCITRAL.

<sup>38</sup> Third sentence of paragraph 28.

<sup>39</sup> Forty-eighth session of the Commission (A/70/17, para. 41)

<sup>40</sup> Sabyasachi, *supra* note 5.

<sup>41</sup> See MINABERE TOM- GEORGE, *supra* note 35, at 39.

<sup>42</sup> Gary B. Born International Commercial Arbitration in the United States (Kluwer Law and Taxation Publishers Deventer 1994 71). However, contra view in L.M. Sharma, International Commercial Arbitration (1994(3) Comp. LJ J-56) that provides if an arbitration agreement is to be classified as domestic agreement only on the basis of arbitration taking place in India then many foreign parties would hesitate to choose India as venue.

<sup>43</sup> It includes procedural powers and duties, procedure for evidence and manner of reference.

<sup>44</sup> Sabyasachi, *supra* note 5.

<sup>45</sup> DICEY AND MORRIS, THE CONFLICT OF LAW (1161 11th ed. vol. II Sweet & Maxwell 2012) (referred from Sabyasachi, *supra* note 5). Also, see Rodney D. Ryder Contracts, *The Choice of Law and International Commercial Arbitration* 2 COMP L.J. J-10 (1999); Jeevan Krishna, *Law of Choice in International Commercial Arbitration*, 20(1&2) ACADEMY LAW REVIEW 61-78.

<sup>46</sup> Clayton Utz A Guide to International Arbitration 2nd edn. <https://www.claytonutz.com/ArticleDocuments/178/Clayton-Utz-Guide-to-International-Arbitration-2012.pdf.aspx?Embed=Y>.

- whether there are any reciprocal treaties or conventions;
- if there are no reciprocal treaties or conventions, then earlier decisions on enforcement of the court are seen;
- if the unsuccessful party is a State or State entity the laws of that country in relation to State immunity.<sup>47</sup>

Section 28 (1)(b), 1996 Act in international arbitration provides:

- the arbitral tribunal shall decide the dispute in accordance with the rules of law designated by the parties as applicable to the substance of the dispute;
- any designation by the parties of the law or legal system of a given country shall be construed, unless otherwise expressed, as directly referring to the substantive law of that country and not to its conflict of laws rules;
- failing any designation of the law under section 28(1)(a) by the parties, the arbitral tribunal shall apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute.

### *Judicial Response*

The Supreme Court of India has adopted path-breaking rulings that bespeak the judicial independence courts enjoy in India to freely interpret the law in keeping with international standards and future of global trade.<sup>48</sup> The choice of the place of arbitration is important, keeping in view, the serious consequences of the arbitration process and it is important that parties consider this issue seriously. The factors to consider when choosing the place of arbitration are (1) the law that the parties wish to have governing the arbitration; (2) the application of the New York Convention and the UNCITRAL Model Law; (3) restrictions on appeal and nationality; (4) language; (5) practical considerations; (6) jurisdiction-specific issues.<sup>49</sup>

In international commercial arbitration, the judicial perspective is touching new heights each day like the ‘venue of arbitration’. In 1992, in the case of *National Thermal Power Corporation v. Singer Co.*<sup>50</sup> the arbitration clause provided that in case of foreign contractor, the arbitration shall be conducted by three arbitrators, two by parties themselves and third by the President of the International Chamber of Commerce, Paris. ICC rules of conciliation and arbitration shall apply. The place shall be as determined by the arbitrators. The question in issue was whether the mere fact that the venue chosen by the ICC Court for the conduct of the arbitration proceeding was London excludes the operation of the Act which dealt with domestic awards i.e. the Act of 1940. In a significant sentence, the Court went on to hold:

*“Notwithstanding that award was a foreign award, since the substantive law of the contract was Indian law and since the arbitration clause was part of the contract, the arbitration clause would be governed...the jurisdiction exercisable by the English courts and the applicability of the laws of that country in procedural matters must be viewed as concurrent and consistent with the jurisdiction of the competent Indian courts and the operation of Indian laws in all matters concerning arbitration insofar as the main contract as well as that which is contained in the arbitration clause are governed by the laws of India.”*

In the case of *Sumitomo Heavy Industries Limited vs. ONGC Limited*<sup>51</sup> the Court observed that the party autonomy being the brooding and guiding spirit in arbitration, the parties are free to agree on application of three different laws governing their entire contract-(1) proper law of contract, (2) proper law of arbitration agreement and (3) proper law of the conduct of arbitration, which is popularly and in legal parlance known as curial law. Where the contract is governed by Indian law and the seat of the arbitration

<sup>47</sup> HARSH SETHI, *supra* note 16, at 258.

<sup>48</sup> Yogesh Pratap, *supra* note 6.

<sup>49</sup> Houthoff Buruma, *International Commercial Arbitration : An Introduction* (January 7, 2017) [http://www.houthoff.com/uploads/tx\\_hhpublications/International\\_Commercial\\_Arbitration\\_2013.pdf](http://www.houthoff.com/uploads/tx_hhpublications/International_Commercial_Arbitration_2013.pdf).

<sup>50</sup> (1992) 3 SCC 551.

<sup>51</sup> 1998) 1 SCC 305.

is elsewhere, wherein arbitrability of the dispute is established, procedural law of the country of seat of arbitration governs the conduct of the arbitration proceedings till the award is delivered.

In 2002, in *Bhatia International v. Bulk Trading S.A. and Anr.*<sup>52</sup>, an application was made under section 9, 1996 Act to safeguard the assets of the Indian company in case a foreign award was to be executed in India against it. The Court revived the doctrine of concurrent jurisdiction by holding “*even where arbitrations are held outside India, unless the parties agree to exclude the application of Part-I of the Arbitration Act, 1996, either expressly or by necessary implication, the courts in India will exercise concurrent jurisdiction with the court in the country in which the foreign award was made*”.<sup>53</sup>

Here, the lacunae in legislative provisions, section 2<sup>54</sup> does not have exceptions of application of Articles 8,9, 35 and 36, justified the implementation of Model Law.<sup>55</sup> Also, the aim of this Act led the Court to give preference to intention of parties than to law of any country. However, it had adverse impact on foreign direct investment and insist of coverage of legal risk. It makes transactions commercially impractical. Consequently, the Supreme Court decisions are disincentives to any long-term investment transaction and to entrepreneurial cooperation.<sup>56</sup>

In 2005, *Shin- Etsu Chemicals Co’ Ltd. vs. Akash Optifibres Ltd.*<sup>57</sup> the Court held that proper of arbitral agreement is the substantive law governing the contract because it has the closest and most real connection with the transaction.

In 2008, *Venture Global Engineering vs. Satyam Computer Services Ltd.*<sup>58</sup> the Supreme Court held that foreign award would also be considered as domestic award and the challenge procedure under Section 34, 1996 Act is allowed. This led to a situation where the foreign award could be challenged in the country in which it is made; it could also be challenged under Part-I of 1996 Act in India; and could be refused to be recognized and enforced in Section 48 contained in Part II of 1996 Act. This case is divergent from the basic scheme of Act and has brought uncertainty in the mind of parties. This case is overruled.

In *Dozco India Pvt. Ltd vs. DOOSAN Infracore Company Ltd*<sup>59</sup> the governing laws of the Contract were the laws of South Korea and in arbitration matters, all disputes arising in connection with the agreement, shall be finally settled by arbitration in Seoul, Korea or such other place as the parties may agree in writing, pursuant to the Rules of the Agreement then in force of the ICC. The Court held that there is no application of Part-I, 1996 Act.

In *Yograj Infrastructure Ltd. v. Ssang Yong Engg. and Construction Co. Ltd.*<sup>60</sup> the distinction between the “proper law” of the contract and the “curial law” determines the law which will govern the arbitration. The proper law is the law which governs the agreement itself. In the absence of any other stipulation in the arbitration, it will be the law governing the contract which would also be the law applicable

<sup>52</sup> (2002) 4 SCC 105.

<sup>53</sup> Paragraph 32 of Bhatia case(2002).

<sup>54</sup> Section 2(2) reads, “this part shall apply where the place of arbitration is in India.”

<sup>55</sup> Nidhi Gupta, *Enforcement of Foreign Awards under The Arbitration and Conciliation Act, 1996 : A Review of the Supreme Court Judgment in Venture Global Engineering Case* 257 49(2) IJIL 2009.

<sup>56</sup> Karan Singh Tyagi, *A second look at international arbitration*, THE HINDU <http://www.thehindu.com/opinion/lead/a-second-look-at-international-arbitration/article2735659.ece> as on December 22, 2011.

<sup>57</sup> (2005) 7 SCC 234.

<sup>58</sup> (2008) 4 SCC 190. Here, the contract is between venture global and satyam computers that they will be governed by laws of Michigan (state in USA), here the principal office is also established, and in case of impossibility to resolve then the matter will be as per LCIA. The LCIA passed an award on which Satyam computer filed for recognition and enforcement in US. Venture filed cross petition and objected its violation in India. Later, matter came before courts in India.

<sup>59</sup> (2011) 6 SCC 179. similar judgment is delivered in *Videocon Industries Ltd. v. Union of India & Anr.*, (2011) 6 SCC 161 where the parties agreed that the arbitration agreement would be governed by the laws of England, while the seat of arbitration was at Kuala Lumpur, and the governing law of the contract was Indian law.

<sup>60</sup> (2011) 9 SCC 735.

to the Arbitral Tribunal itself. The curial law regulates the procedure to be adopted in conducting the arbitration would be the SIAC Rules.

In 2012, *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*<sup>61</sup> the parties agreed that i) disputes arising out of the Contract between the parties are to be resolved by arbitration under the ICC Rules; ii) the seat of arbitration is Paris; iii) the substantive law to be applied in the arbitration shall be English Law (Article 22). The matter is earlier referred to two judge bench which disagreed with Bhatia case, so case is heard by Constitutional bench. The Court held that Part-I will not apply to international arbitration outside India. Also, ‘seat theory’ is developed to decide the applicable law of arbitration and have power to annul the award. The Court stated that the seat of arbitration as the ‘centre of gravity’ of an arbitration particularly to determine jurisdiction of courts in relation to that arbitration. “Where the parties have failed to choose the law governing the arbitration proceedings, those proceedings must be considered, at any rate prima facie, as being governed by the law of the country in which the arbitration is held, on the ground that it is the country most closely connected with the proceedings”. Also, Interim measures under Section 9 cannot be granted in arbitrations taking place outside India.

If an international arbitration takes place, irrespective of the seat, and the subject matter of that arbitration would otherwise be within the jurisdiction of an Indian Court, such Indian Court would have ‘supervisory jurisdiction’. Therefore, if “the closest connection” of the arbitration is with India, and if the Indian Courts would normally have jurisdiction over the dispute, the Indian Courts will play a supervisory role in the arbitration.

This case has prospective effect that is agreements after 6.9.2012 which resulted in no application in the present times. The ‘seat theory’ influences the law that will govern arbitration; decides which court will have supervisory power and determines the nationality of award.<sup>62</sup> Also, non-convention awards are not covered.<sup>63</sup>

In 2014, *Enercon India Ltd vs. Enercon GmbH*<sup>64</sup> the parties agreed to have “seat” of arbitration in India and London to be the “venue” to hold the proceedings of arbitration. Law governing the Contract, arbitration agreement and Curial law are Indian laws. In the present case, the Supreme Court held that even though the venue of proceedings is London, it cannot be presumed that the parties have intended the seat to be London. Venue is often different from the seat of arbitration and should not be confused because of convenient geographical location. The hearing of the arbitration will be conducted at the venue fixed by the parties, but this would not bring about a change in the seat of the arbitration.

If the “seat” of arbitration is in India; the 1996 Act being the curial law, recourse to Indian Courts as per Part I of the 1996 Act, including Section 9 is available to the parties. The “seat” of arbitration thus, would be the country whose law is chosen as the curial law by the parties.<sup>65</sup> Applying the “closest and intimate connection test” to arbitration, parties had agreed for arbitration proceedings under 1996 Act.

In the case of *Union of India (UOI) vs. Reliance Industries Limited(Reliance) and Ors.*<sup>66</sup> there is a contract of Production Sharing between Reliance, UOI, Enron Oil and Gas India Limited and the ONGC. In 2005, Enron Oil and Gas India Limited are substituted with BG Exploration and Production India Limited. In 2010, disputes arose between the Union of India and Reliance. The arbitrators are appointed.<sup>67</sup> In 2011, the UOI, Reliance Industries and BG Exploration and Production India, agreed to change the seat

<sup>61</sup> (2012) 9 SCC 552.

<sup>62</sup> JULIAN, *supra* note 22, at 172.

<sup>63</sup> Sumbhav Nagory and Ananya Kapoor *International Commercial Arbitration — A Critique of Balco V. Kaiser Aluminium*, (2013) 1 MLJ 92.

<sup>64</sup> (2014) 5 SCC 1.

<sup>65</sup> Shivam Goel, *International Commercial Arbitration — India (January 4, 2017)* [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2585435](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2585435).

<sup>66</sup> 2015(10) SCALE149.

<sup>67</sup> The Union of India appointed Mr. Peter Leaver, QC as Arbitrator and Reliance Industries appointed Justice B.P. Jeevan Reddy as Arbitrator and Mr. Christopher Lau SC was appointed as Chairman of the Tribunal.

of arbitration to London, England and a final partial consent award was made and duly signed by the parties to this effect. In 2012, the tribunal passed an award. UOI filed a petition before Delhi High Court to set aside the arbitral award under Section 34, which was allowed. However, the Supreme Court reversed the judgment in 2014.<sup>68</sup> In the meantime, in 2014 special leave petition was filed before the High Court and has been dismissed. The petition was made under Section 14<sup>69</sup>. The Supreme Court observed that the proper law of the contract is Indian law and proper law of the *arbitration agreement* is the law of England. In order, to understand whether parties intended to exclude jurisdiction of India can be understood from the arbitration agreement and referred Bhatia case, 2002. The court also noted that BALCO case because of prospective application cannot be referred.

Secondly, the ‘doctrine of concurrent jurisdiction’ cannot be allowed as the ‘juridical seat’ of the arbitration is at London and that the arbitration agreement is governed by English law. Allowing this doctrine to prevail, will result in concurrent jurisdiction at two places is incorrect. The Supreme Court dismissed the petition and held,

*“Where such arbitration is held in India, the provisions of Part I would compulsorily apply and parties are free to deviate only to the extent permitted by the derogable provisions of Part I. In cases of international commercial arbitrations held out of India provisions of Part I would apply unless the parties by agreement, express or implied, exclude all or any of its provisions. In that case the laws or rules chosen by the parties would prevail. Any provision, in Part I, which is contrary to or excluded by that law or rules will not apply.”*

*The ground of ‘public policy’ cannot be applied as jurisdiction before English Court is open.* In Singer case (1992) the Court did not give effect to the difference between substantive law of contract and the law that governed the arbitration on basis of section 9, Foreign Awards (Recognition And Enforcement) Act, 1961<sup>70</sup>. This later led to omission of the word in section 9(b), 1961 while enacting Section 51, 1996 Act<sup>71</sup>. Also, concurrent jurisdiction was done away with.

In 2013, Court paved a way for referring non-signatories to an arbitration agreement to settle disputes through arbitration in the case of *Chloro Controls (I) P. Ltd. v. Severn Trent Water Purification Inc. & Ors.*<sup>72</sup> in the expression ‘*person claiming through or under*’ as provided under Section 45 of the Arbitration Act would mean and include multiple and multi-party agreements. This judgment will have far-reaching positive effect especially in the cases of international commercial arbitrations involving composite transactions and multiple parties. In the case of *World Sport Group (Mauritius) Ltd. vs MSM Satellite (Singapore) Pte. Ltd.*<sup>73</sup> the Supreme Court has eased the arbitrability of cases involving allegations of fraud for referring such matters and parties to foreign seated arbitrations to meet legal requirements.

*In Harmony Innovation Shipping Ltd.*<sup>74</sup> the Court observed that the law governing the substantive contract; the law governing the agreement to arbitrate and the performance of that agreement; the law governing the conduct of the arbitration.

<sup>68</sup> Reliance Industries Limited and Anr. v. Union of India, (2014) 7 SCC 603.

<sup>69</sup> Section 14 is on **Failure or impossibility to act**.

<sup>70</sup> Nothing in this Act shall-(a) prejudice any rights which any person would have had of enforcing in India of any award or of availing himself in India of any award if this Act had not been passed; or (b) apply to any award made on an arbitration agreement governed by the law of India. Retrieved from <https://indiankanoon.org/doc/882364/> as on December 26, 2016.

<sup>71</sup> **51. Saving.** — Nothing in this Chapter shall prejudice any rights, which any person would have had of enforcing in India of any award or of availing himself in India of any award if this Chapter had not been enacted.

<sup>72</sup> 2013(1)SCC641.

<sup>73</sup> (2014)11SCC639.

<sup>74</sup> AIR2015SC1504.

In the case of *ROHM and HAAS Electronic Materials Holding UK Limited vs. R.B. Business Promotions Pvt. Ltd.*<sup>75</sup> contract provided the arbitration agreement to be governed by Indian Law and seat of arbitration is mentioned as U.K. However, before the commencement of the arbitration proceeding, the parties agree that though the physical seat of arbitration is in U.K., for all purposes the seat of arbitration shall be deemed to be India and the arbitral proceedings shall be conducted under the curial law of India. In this situation, though all the conditions under section 44 were satisfied the award by the arbitrator cannot be said to be a foreign award.

In 2016, *Bharat Aluminium Company Vs. Kaiser Aluminium Technical Services Inc*<sup>76</sup>, the Court held that Part I applies only to arbitration held in India. This case cover the residue of BALCO, 2012 and discusses the agreement by parties to be governed by the prevailing law of India and in case of Arbitration, the English Law shall apply (article 22). The Court held that the proper law of contract is Indian law. Looking at article 17 noted it is solely on arbitration. Therefore, the intention of the parties to apply English Law to the arbitration agreement also and not limit it to the conduct of the arbitration is fairly clear from Article 22.

### *Conclusion and Suggestions*

In international arbitration, the vigilant attitude of parties while choosing seat of arbitration and law to be made applicable to said arbitration is the utmost requirement. In foreign seated arbitration governed by foreign law, there is implied exclusion of Sections 9, 27 and 37, 1996 Act. When a foreign seated international arbitration is governed by Indian law, Part I will apply.

- Problem of conflicting awards as each award stands on its own and there is no binding effect.
- Preference to International Law.
- International Arbitration to be delocalised. It is completely separated from the law of the place of arbitration for enforcement purposes like sports arbitration. Also, it is not extra-legal arbitration. However, drawbacks like threat to fairness; no supervisory intervention of courts; limiting scope of public policy.<sup>77</sup> It cannot operate in legal vacuum.<sup>78</sup>
- Setting up a common legal system for international arbitration.
- Minimising the supervisory role played by different nations.
- More application of general principles of law (*lex mercatoria*)
- Need to develop rules for arbitration awards rendered in a non-convention country as it might not be enforceable in other countries.

<sup>75</sup> 222(2015)DLT224.

<sup>76</sup> 2016(2)SCALE60.

<sup>77</sup> Suharsh Sinha *Issues of Arbitrability in International Commercial Arbitration : The Present Position* (2007(4) Arb.L.R. J 9-16).

<sup>78</sup> JULIAN, *supra* note 22, at 67.



## *Session 9 — New frontiers in dispute settlement*

### *Bilateral Arbitration Treaties: An Improved Means of International Dispute Resolution*

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#### *I. Introduction*

1. This paper examines the subject of bilateral and multilateral arbitration treaties (or “BATs”) and outlines the benefits that such treaties would provide to States and commercial parties. As discussed below, BATs would establish arbitration as a default mechanism to resolve international commercial disputes between businesses that are located in the States party to the BAT.

2. BATs are a topic of increasing and substantial interest. Proponents of BATs argue that these treaties offer significant benefits to international businesses by providing access to more efficient, expert, and enforceable dispute resolution mechanisms, applying neutral and fair procedures. In doing so, BATs facilitate international trade and commerce, particularly involving small and medium-sized enterprises, while also providing enhanced access to justice. Several States have indicated interest in BATs, and the concept has generated considerable professional interest in legal and business communities, particularly in recent years.

3. This paper considers how the study of BATs would tie into the work of UNCITRAL and the benefits that such a study would bring both to UNCITRAL and the larger international community.<sup>1</sup> By supporting a study of BATs, UNCITRAL could ultimately develop a model instrument that forms a precedent for States that wish to conclude BATs with each other. Such a model BAT would stand on the shoulders of some of UNCITRAL’s most successful accomplishments — the UNCITRAL Arbitration Rules and the UNCITRAL Model Law on International Commercial Arbitration (or “Model Law”) and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (or “New York Convention”), the promotion of which is an integral part of UNCITRAL’s work.<sup>2</sup>

4. Part II of this paper explains how the current shortfalls in international dispute resolution increase barriers to trade and foreign direct investment (“FDI”) and the role BATs can play to mitigate these concerns. Part III explores the deficiencies in contemporary international dispute resolution and the benefits of BATs through the lens of two traditionally disadvantaged groups — developing small States and small and medium sized enterprises (“SMEs”). Part IV draws attention to further areas of research on BATs that UNCITRAL could explore. Part V provides some concluding observations.

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<sup>1</sup> The authors have previously published on the novel concept of a BAT. Mr. Born has proposed a Draft Model BAT and Draft Commentary on a Model BAT that have been made available for public comment. See Draft Model Bilateral Arbitration Treaty, [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/News/Documents/Draft-Model-BAT.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/News/Documents/Draft-Model-BAT.pdf) (last accessed on 29 November 2016); Draft Commentary on Model Bilateral Arbitration Treaty, [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf) (last accessed on 29 November 2016); see also Gary Born, “BITs, BATs and Buts: Reflections on International Dispute Resolution” in *Young Arbitration Review* (2011), 6-14. Dr. Butler has examined the potential of such a BAT, specifically for small and medium enterprises (SMEs) in New Zealand. See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221.

<sup>2</sup> See United Nations Commission on International Trade Law, *New York Arbitration Convention*, <http://www.newyorkconvention.org/uncitral> (last accessed on 29 November 2016).

5. Attached to this paper is a draft model BAT (Annex A), together with an explanatory commentary that discusses each article of the draft model BAT (Annex B).<sup>3</sup>

## II. *BATS, Barriers to Trade and International Dispute Resolution*

### A. *Deficiencies in International Dispute Resolution as Barriers to Trade*

6. Current mechanisms for resolving international disputes have not kept pace with the cross-border dimension of 21<sup>st</sup>-century commerce. Doing business globally therefore faces the risks and uncertainties of inconsistent or conflicting national laws; biased, inefficient, inexperienced, or otherwise unsuitable decision-makers; inconsistent dispute resolution proceedings; and severe obstacles to the enforcement of judgments.

7. More specifically, current risks in international dispute resolution include:

a. **Lack of Neutrality:** Many international commercial disputes are, by default, resolved by litigation in national courts. However, commercial parties frequently doubt that national courts, particularly the courts of the jurisdiction of their counter-party, will render an unbiased and competent decision.<sup>4</sup> In many instances, well-documented concerns about corruption and the integrity of national courts further erode confidence in cross-border litigation.<sup>5</sup>

b. **Lack of Experience and Expertise:** International commercial disputes are often complex. Many such disputes arise in specialized sectors, with complex business customs and technical issues (e.g., oil and gas disputes; insurance and reinsurance disputes; commodities transactions; M&A disputes). Very few, if any, national courts can consistently provide the specialized expertise appropriate for such disputes. Moreover, even disputes with simple factual matrixes become complex when a foreign law must be applied. Some national courts are well-versed in resolving cross-border disputes, but many are not. Particularly in emerging markets, courts may have limited experience in resolving cross-border disputes or may generally lack experienced commercial judges.

c. **Risk of Parallel or Multiple Litigation:** In practice, cross-border disputes often lead to litigation in multiple fora<sup>6</sup> — the place of performance, the jurisdiction of the counter-party, the enterprises' own national courts and jurisdictions where the counter-party has assets for enforcement — with each proceeding potentially involving multiple appellate levels. The complexity of handling multiple proceedings is compounded by the inevitable risk of conflicting decisions.

d. **Cost and Time to Resolve Disputes:** The very real risk of multiple parallel proceedings in cross-border disputes also leads to prohibitive costs and delays. Parties often have to “layer” counsel, first engaging local counsel and then appointing foreign counsel in each of the various relevant jurisdictions.<sup>7</sup>

<sup>3</sup> The draft Model BAT and accompanying commentary are also available online at [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/News/Documents/Draft-Model-BAT.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/News/Documents/Draft-Model-BAT.pdf) and [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf) respectively.

<sup>4</sup> See Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16<sup>th</sup> edition, OUP 2015, at para. 1.99 et seq.; Julian D. M. Lew, Loukas A. Mistelis, Stefan Michael Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International 2003, at para. 1-13.

<sup>5</sup> See Transparency International, *Global Corruption Report 2007: Corruption in Judicial Systems* (2007), at p. xxi (“Corruption is undermining justice in many parts of the world, denying victims and the accused the basic human right to a fair and impartial trial.”).

<sup>6</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 199.

<sup>7</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 202 et seq.



Moreover, enforcement of judgments often requires multiple sets of lawyers in different jurisdictions. In many cases, litigation is slow, with proceedings taking many years to conclude before being subject to even lengthier delays for appellate review, and further delays for enforcement.

e. **Obstacles to Enforceability of Judgments and Forum Selection Provisions:** Different jurisdictions apply different rules (often uncertain national rules) when enforcing foreign judgments and forum selection clauses. Assuming the parties obtain a judgment from a national court, it is often difficult or impossible for the judgment to be enforced abroad, in particular in jurisdictions where the defendant has assets.<sup>8</sup> While there are frameworks for the enforcement of judgments between certain countries, there is as yet no comprehensive mechanism that ensures recognition of a State court's judgment in most other countries.<sup>9</sup> Even where enforcement is possible, the process is invariably slow.

f. **Uncertainty and Unpredictability:** The factors outlined above introduce a significant degree of uncertainty and unpredictability, which in turn has a chilling effect on international business. These risks drive up the costs of international commerce and may prevent many potential participants from expanding internationally.

8. In sum, international dispute resolution today, with the default of national court litigation, is unsatisfactory, leading to less trade and economic growth globally.<sup>10</sup> The current system also produces significant obstacles to the neutral and objective resolution of claims by private businesses, resulting in serious unfairness in some cases.

#### *B. Bilateral Arbitration Treaties — Reducing Barriers to Trade and Promoting FDI*

9. Various efforts have been undertaken to mitigate the legal risks and uncertainties of cross-border trade and investment, including (i) the wide-spread ratification of international commercial and investment arbitration treaties (notably, the New York Convention and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “ICSID Convention”)); (ii) the development of institutional arbitration (including through the promotion of institutional arbitration rules, like the UNCITRAL Rules); and (iii) the negotiation of treaties for the recognition of foreign judgments (like the Hague Convention on Choice of Court Agreements (“Hague Convention”)).

10. Virtually all these efforts however assume that international businesses will conclude agreements (pre or post-dispute) to resolve disagreements. The New York Convention, the ICSID Convention and the Hague Convention all require either a valid agreement to arbitrate or a forum selection agreement. Absent such agreement, the default means of cross-border dispute resolution remains litigation in (multiple) national courts, with all the deficiencies detailed above. BATs were conceived as an innovative way of mitigating these deficiencies and the unique risks and uncertainties that impede international trade and investment.

11. A BAT is a treaty between two States that provides for (i) international commercial disputes (ii) between commercial enterprises based in the two State parties to the treaty (iii) to be finally resolved by arbitration.<sup>11</sup> Commercial parties would be free to opt-out of the BAT regime by (i) selecting another form or forum for dispute resolution (such as mediation or litigation) or (ii) modifying the arbitration procedure provided for under the BAT (including the applicable arbitration rules).<sup>12</sup>

<sup>8</sup> See James Fawcett and Janeen M. Carruthers, *Cheshire, North & Fawcett: Private International Law*, 14<sup>th</sup> edition, OUP 2008, at p. 514 et seq.

<sup>9</sup> See James Fawcett and Janeen M. Carruthers, *Cheshire, North & Fawcett: Private International Law*, 14<sup>th</sup> edition, OUP 2008, at p. 514 et seq. The possible adoption of the Hague Convention might, over time, reduce these risks, but this will be a long-term process with uncertain results. At present, the European Union, Singapore, and Mexico have ratified the agreement but widespread ratification does not seem likely in the near to mid-term.

<sup>10</sup> European Commission, *European contract law in business-to-business transactions: Summary* (2011); World Bank and the International Finance Corporation, *Doing Business 2012* (2012) — both studies found that international litigation poses a significant trade barrier for SMEs and businesses in general.

<sup>11</sup> Draft Model BAT, Article 2.

<sup>12</sup> Draft Model BAT, Article 5.

12. BATs therefore change the default system of cross-border commercial dispute resolution from national court litigation to international arbitration. In doing so, BATs build on the experience of the New York Convention, the UNCITRAL Model Law, and international arbitral institutions, to provide a more expert, efficient, and enforceable means of dispute resolution.

13. In practice: If States A and B conclude a BAT, international commercial disputes between enterprises based in States A and B would be resolved by arbitration as provided for in the BAT, unless the commercial parties have agreed to a different mechanism. If a business based in State A attempted to bring a dispute against a business based in State B to a national court in State A or State B, that court would have to refer the parties to arbitration.<sup>13</sup> Courts in either State also would have to recognize and enforce any awards made by arbitral tribunals under the BAT.<sup>14</sup> Consequently, from the points of view of States A and B and businesses based in these States, the complex and often archaic system of international civil procedure and jurisdiction would be replaced with a modern, efficient and straight-forward mechanism of treaty-based commercial arbitration.

14. States would negotiate the terms of their BATs on a bilateral basis, taking into account their particular needs and the requirements of the relationship with the other treaty State. Individual BATs may take different shades in areas including the scope of their application, the default seat and arbitral process, whether mediation and negotiation should be required prior to arbitration, the degree of transparency and the terms of judicial intervention and enforcement. It can for example be expected that most States would choose to exclude consumer disputes, employment disputes, disputes over matrimonial, domestic and inheritance matters and other similar categories of non-commercial disputes from the scope of their BATs. States could also exclude types of commercial disputes, e.g. ones involving certain environmental, quasi-criminal or bankruptcy related issues. In the interest of legal certainty, it would be desirable for any BAT to clearly delineate the limited categories of disputes not covered, so that it can otherwise function as a “catch-all” dispute resolution mechanism between the contracting States.

15. While States can (and undoubtedly will) give their individual touch to the BATs they enter into, such freedom comes at a cost. Enterprises engaged in international commerce seldom do business with counterparties in just one other State. Their commercial relationships will therefore be governed by not only one, but many of the BATs entered into by their home State. If these BATs are too different from each other, transaction costs will increase and the full potential of efficiency, simplicity, and fairness inherent in the idea of BATs will not be fully realized. It is therefore desirable for BATs to be built on a common foundation: a Model BAT that provides a sensible and unitary framework that States can, to the extent necessary, fine-tune to their individual needs.

16. Although proposed in the form of a bilateral treaty, the concept of a BAT can be modified into a multilateral arbitration treaty (a “MAT”) between a number of States, for instance, in a geographic region (e.g., ASEAN or the Pacific Islands). The dispute resolution provisions of a BAT or MAT could also form part of a larger free trade agreement (“FTA”), much like the investment chapter of FTAs.

17. The success of UNCITRAL’s creations, such as the Model Law, demonstrate that such models provide a good compromise: States retain the ability to shape the model to their individual needs by making careful adjustments, but these individual implementations will retain sufficient commonality. This provides considerable international legal certainty and allows businesses to operate with confidence outside of their home jurisdictions — without the need to familiarize themselves with a multitude of entirely different legal frameworks.

18. Thus with BATs, instead of fearing the potential bias of national courts, parties can trust in neutral decision-makers of their choice.<sup>15</sup> Instead of being limited by the experience and resources of a specific set

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<sup>13</sup> Parallel to the functioning of Article II of the New York Convention.

<sup>14</sup> Taking into account the well-established limitations to the recognition and enforcement of arbitral awards that would be modelled after Article III, IV and V of the New York Convention.

<sup>15</sup> See Emmanuel Gaillard and John Savage, *Fouchard Gaillard Goldman on International Commercial Arbitration*,

of national courts, parties can freely choose legal experts appropriate to their dispute.<sup>16</sup> Instead of having to conduct multiple proceedings, parties can focus even multi-dimensional disputes in one arbitration.<sup>17</sup> Instead of spending money on numerous different national counsel and several appellate layers, arbitration provides a cost-efficient one-shot solution to quickly and efficiently resolve commercial disputes.<sup>18</sup> Instead of a judgment that might be worthless wherever the losing party has assets, the claimant will have a widely enforceable arbitral award potentially under the New York Convention or similar instruments.<sup>19</sup>

19. BATs in effect capitalize on all the advantages of arbitration that have today made it the preferred choice of dispute resolution for international trade<sup>20</sup> — neutrality, efficiency, expertise, finality, and enforceability. By reducing the risks of cross-border dispute resolution, BATs mitigate a significant barrier to trade and will encourage more businesses to engage in FDI and international trade. As one commentary notes, “[a] BAT would — by directing the resolution of disputes to arbitration — serve to give [MSMEs] greater access to justice in the international space than is available under the status quo.”<sup>21</sup>

20. That said, the authors do not posit that arbitration is perfect — no dispute resolution mechanism can and will ever be. The vibrant discussions within UNCITRAL Working Group II on Arbitration and Conciliation / Dispute Settlement demonstrate that the law and practice of arbitration is constantly evolving — simultaneously underscoring the need for these improvements. But when it comes to resolving international commercial disputes, arbitration is — by a wide margin — the most expert, most fair, most efficient, and most neutral form of cross-border dispute resolution.

### *III. Bilateral Arbitration Treaties Through the Lens of Developing Small States and SMEs*

21. While the pitfalls of international dispute resolution today affect all market participants in international commerce, some players are better able to compensate for these inherent deficiencies than others. Larger States have more resources available to maintain an effective judiciary. Large businesses have the knowledge and resources to avoid international litigation by individually tailoring arbitration agreements. In contrast, developing small States and SMEs are less equipped to address the pitfalls of the current default system, amplifying existing power-asymmetries by putting developing small States and SMEs at a disadvantage. The following sections explore these points and highlight how BATs could alleviate some of these concerns.

#### *A. Developing Small States Moving from International Litigation to BATs*

22. Although there are different definitions of what constitutes a small State,<sup>22</sup> small States, in particular those that are developing, face similar sets of challenges including remoteness and insularity, susceptibility

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Kluwer Law International 1999, at p. 1; Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16<sup>th</sup> edition, OUP 2015, at para. 1.99 et seq.

<sup>16</sup> See Julian D. M. Lew, Loukas A. Mistelis, Stefan Michael Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International 2003, at para. 1-25; Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16<sup>th</sup> edition, OUP 2015, at para. 1.71 et seq.

<sup>17</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 199.

<sup>18</sup> See Julian D. M. Lew, Loukas A. Mistelis, Stefan Michael Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International 2003, at para. 1-28, 1-30; Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16<sup>th</sup> edition, OUP 2015, at para. 1.125.

<sup>19</sup> See Julian D. M. Lew, Loukas A. Mistelis, Stefan Michael Kröll, *Comparative International Commercial Arbitration*, Kluwer Law International 2003, at para. 1-21; Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16<sup>th</sup> edition, OUP 2015, at para. 1.102.

<sup>20</sup> *2015 International Arbitration Survey: Improvements and Innovations in International Arbitration* (Queen Mary University, 2015), at p. 5.

<sup>21</sup> Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 189.

<sup>22</sup> See Matthias Maass, “The elusive definition of the small state” in *International Politics* (2009) 46, 65-83, at p.

to natural disasters, limited institutional capacity, limited diversification, reliance on external trade and investment, the need to access external capital and poverty.<sup>23</sup> When it comes to international commercial dispute resolution these challenges include a lack of human (legal) resources,<sup>24</sup> a lack of financial resources to invest in the legal sector and a developing judiciary.

23. Furthermore, many developing small States lack treaty arrangements on the enforcement of their judgments abroad or the domestic enforcement of foreign judgments (indeed, this is not a problem unique to developing small States, although developed States are better placed and resourced to negotiate such arrangements). As a result, foreign investors face a real risk of substantial delays and ineffective justice in case of a dispute. These factors make such States riskier for business, inhibiting trade and the inflow of FDI. In a number of related ways, default arbitration under a BAT is capable of alleviating some of these pressures.

24. First, from the perspective of businesses operating out of or into developing small States, expert arbitration replaces less experienced courts. Currently, parties might choose a neutral third-party country's court to resolve their international disputes as an alternative to local courts.<sup>25</sup> This is particularly unsatisfactory for developing small States and their businesses. For instance, a judge in Singapore is unlikely to be familiar with the commercial realities of the fisheries business between Vanuatu and Fiji. Arbitrators are chosen for their individual expertise.<sup>26</sup> By providing arbitration as a default mechanism, more disputes can be handled by individuals hand-picked for their familiarity with the relevant region and business sector. Disputes will be handled at a reduced cost in a more expert and efficient fashion.

25. Second, BATs provide businesses with greater certainty in the enforceability of decisions under the New York Convention. Developing small States can therefore assure investors that they will see the fruits of their litigation which will not be rendered a mere paper victory.

26. Third, from the perspective of the State, the expenses of maintaining the judiciary will be reduced by relieving docket congestion. National courts can focus on resolving domestic disputes and strengthening the local rule of law. They can also reduce the need to expend resources on resolving complex international disputes that involve the application of foreign law. At the same time, BATs would provide local lawyers, and indirectly courts, with alternative models of dispute resolution, ultimately enhancing the quality and efficiency of local litigation.

27. Fourth, BATs could be used to enhance capacity building for the local legal community. The ability to select arbitrators is an essential component of arbitration<sup>27</sup> that should not be restrained by BATs; indeed, one of the advantages of default arbitration will be that parties can source counsel and arbitrators globally. Nonetheless, States can consider crafting their BATs to provide for local arbitral institutions and/or local arbitrations (by setting the nationality of arbitrators to be appointed). Capacity building can occur on a regional basis, where small States with a common cultural and legal heritage can jointly develop a regional capacity for the enhanced resolution of commercial disputes.

28. This coincides with the desire of parties to choose decision-makers familiar with the cultural nuances of the parties and the place of performance of the agreement. Such local capacity building will also

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65. Criteria for smallness include quantitative measures such as GDP, income per capita and population as well as qualitative measures rooted in geography, economics and politics — these are often relational, i.e. measured not in isolation but by a context-dependent reference frame and by how a State fits into the global system.

<sup>23</sup> See Report of the Commonwealth Secretariat / World Bank Joint Task Force on Small States, *Small States — Meeting Challenges in the Global Economy* (2000), at p. 5.

<sup>24</sup> See Lino Briguglio, "Small Island Developing States and their Economic Vulnerabilities" in *World Development* (1995) Vol. 23, No. 9, 1615-1632, at p. 1617.

<sup>25</sup> See Gary Born, *International Commercial Arbitration*, Kluwer Law International 2014, at p. 75.

<sup>26</sup> See Gary Born, *International Commercial Arbitration*, Kluwer Law International 2014, at p. 80 et seq.

<sup>27</sup> See Emmanuel Gaillard and John Savage, *Fouchard Gaillard Goldman on International Commercial Arbitration*, Kluwer Law International 1999, at p. 451 et seq.

contribute to on-going efforts of the international arbitration community to expand, diversify and become more representative.<sup>28</sup>

29. In sum, BATs possess great potential to contribute to the growth of developing small States by making them a more attractive destination to do business. A commitment to international arbitration would assure foreign businesses and investors that their disputes would be resolved fairly and efficiently, and any outcome will be enforceable.

30. No empirical research has at present been done on practically implementing BATs in developing small States. However, the time is ripe for serious discussion on how these instruments should be shaped for developing small States to achieve better leverage in international trade. Inclusive supranational institutions, such as UNCITRAL, are in a prime position to encourage and provide a forum for developing small States to voice their needs in the drafting of a universal Model BAT and to conduct objective research on these needs.

#### *B. Small and Medium Enterprises (SMEs) Moving from International Litigation to BATs*

31. As with small States, there is no international consensus on the definition of Small and Medium Enterprises (SMEs). In New Zealand, for example, SMEs are defined as businesses employing fewer than 100 persons.<sup>29</sup> For the European Union, SMEs are defined as enterprises employing fewer than 250 persons and having an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.<sup>30</sup> In the United States, SMEs are often defined as businesses with fewer than 500 employees.<sup>31</sup> Again, these definitional challenges do not detract from the fact that many SMEs face similar trading challenges vis-à-vis international dispute resolution.

32. SMEs form a substantial part of the domestic economic fabric, yet they are drastically under-represented in international trade. In the context of the United States, for instance, “[m]ost firms are small. By head count, fully 98 percent of all US exporters are small and medium-sized businesses [...], but only 4 percent of the entire population of US SMEs export to global markets. Collectively, these firms accounted for 34 percent of US exports of goods and services in 2012.”<sup>32</sup> Similarly, 75 percent of New Zealand firms have never generated overseas income.<sup>33</sup>

33. According to one study, “[l]imited experience in expanding overseas is the most common barrier to small businesses wanting to export. The most cited barriers revolve around the unfamiliarity of operating in a different country.”<sup>34</sup> Studies have found that SMEs are often concerned about access to justice when it comes to international litigation.<sup>35</sup> Many SMEs are thus unable to engage in beneficial trade and realize their full potential.<sup>36</sup>

<sup>28</sup> See Susan D. Franck, James Freda, Kellen Lavin, Tobias Lehmann, Anne van Aaken, “International Arbitration: Demographics, Precision and Justice”, in Albert Jan van den Berg (ed.), *Legitimacy: Myths, Realities, Challenges, ICCA Congress Series, Volume 18*, Kluwer Law International 2015, at p. 116 et seq.

<sup>29</sup> See Ministry of Business, Innovation & Employment (New Zealand), *The Small Business Sector Report* (2014), at p. 10.

<sup>30</sup> Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361.

<sup>31</sup> See U.S. International Trade Commission, *Small and Medium-Sized Enterprises: Overview of Participation in U.S. Exports* (2010), at 1-3.

<sup>32</sup> Carolin Freund, Gary Clide Hufbauer, Euijin Jung, “Enhancing Export Opportunities for Small and Medium-Sized Enterprises”, Peterson Institute for International Economics, Policy Brief 16-7, June 2016, at p. 2.

<sup>33</sup> “The Small Business Sector Report”, Ministry of Business, Innovation & Employment (New Zealand), 2014, at p. 8.

<sup>34</sup> See Ministry of Business, Innovation & Employment (New Zealand), *The Small Business Sector Report* (2014), at p. 8.

<sup>35</sup> Compare: European Commission, *European contract law in business-to-business transactions: Summary* (2011), World Bank and the International Finance Corporation, *Doing Business 2012* (2012).

<sup>36</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 188.

34. Large corporations typically have in-house legal counsel, in addition to engaging external law firms.<sup>37</sup> These entities are therefore able to manage international commercial disputes that span multiple jurisdictions and have the financial resources to see such disputes through to the end. Furthermore, large corporations also have the resources to design, draft and negotiate tailor-made arbitration agreements. Nonetheless, given the nature of many commercial sectors, these resources are often not used by major corporations — which fail to include dispute resolution provisions (or valid dispute resolution provisions) in their international commercial contracts.

35. In contrast, SMEs typically lack internal legal teams and have limited resources to expend on external local counsel, let alone in multiple jurisdictions. With limited resources and legal staff, the cost of legally pursuing or defending against claims in foreign courts is also often prohibitively high for SMEs.<sup>38</sup>

36. Furthermore, tailor-making dispute resolution clauses is impractical for most SMEs. Designing contracts takes time, knowledge, experience and resources. Designing effective arbitration agreements can be a failure-prone process — if a dispute over the validity of an arbitration agreement ensues, the dispute might end up in court after all.<sup>39</sup> It is also not uncommon for SMEs to conclude oral contracts instead of a formal document. Where written agreements exist, SMEs may be averse to use legalistic language that foreshadows potential disputes; personal relationships are often valued over the certainty of written terms.<sup>40</sup>

37. Default arbitration under a BAT could alleviate many of these concerns for SMEs and level the playing field between larger and smaller corporations. As arbitration would be the default, there would be no cost for SMEs in setting up a dispute resolution mechanism — neither for drafting an arbitration agreement nor as part of a bargain when attempting to include a favourable dispute resolution clause in an agreement. A BAT might also provide optional or mandatory means of alternative dispute resolution (e.g. negotiation, conciliation, mediation) prior to arbitration, giving SMEs the opportunity to solve their dispute informally.<sup>41</sup>

38. A first step to better understand the potential of BATs for SMEs has been taken by the New Zealand Institute of Economic Research (“NZIER”). In 2016, NZIER conducted a study “Evaluating the proposed Bilateral Arbitration Treaty” to assess the practical impact of adopting BATs on New Zealand’s SMEs.<sup>42</sup> The study resulted in a “...broadly positive [response] by the firms in that 66.7% ... preferred arbitration to litigation. The unsure results (30.8%) are symptomatic of the preference for negotiation over litigation or arbitration. Therefore, there is confidence in arbitration as an alternative dispute resolution method.”<sup>43</sup>

39. The study also concluded that “[t]he answers do seem to suggest that a BAT and the proposed benefits could function in [New Zealand].”<sup>44</sup> Yet, the study highlighted that “...it appears that the greatest barrier to the successful implementation of a BAT in New Zealand is the inexperience firms have with arbitration.

<sup>37</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 197.

<sup>38</sup> See Petra Butler and Campbell Herbert, “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty”, *New Zealand Universities Law Review* Vol. 26, 2014, 186-221, at p. 197.

<sup>39</sup> See Gary Born, *International Commercial Arbitration*, Kluwer Law International 2014, at p. 763 et seq.

<sup>40</sup> See in regard to how SMEs contract: Hanneke van Oeveren, “It hurts my head to think about it” *SMEs and the Legal Framework for International Commercial Contracts*, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2791321](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2791321) (last accessed 16 Dec 2016). Compare in regard to the costs for UK small business to engage in dispute resolution domestically: Federation of Small Business (UK), *Tied Up- Unravelling the Dispute Resolution Process for Small Firms* (November 2016), at p. 13 et seq.

<sup>41</sup> See Article 2(a) of the Draft Model Bilateral Arbitration Treaty, which contains a requirement to negotiate in good faith.

<sup>42</sup> See New Zealand Institute of Economic Research (NZIER), *Evaluating the proposed Bilateral Arbitration Treaty*, 25 February 2016, at p. 1, 4, see also Georgia Whelan “Could a BAT fly? An Evaluation of the Proposed Bilateral Arbitration Treaty in the New Zealand Context, 2017 *Victoria University Law Review* [forthcoming].

<sup>43</sup> New Zealand Institute of Economic Research (NZIER), *Evaluating the proposed Bilateral Arbitration Treaty*, 25 February 2016, at p. 6.

<sup>44</sup> New Zealand Institute of Economic Research (NZIER), *Evaluating the proposed Bilateral Arbitration Treaty*, 25 February 2016, at p. 7.

The respondents were wary of the implications of a BAT to their businesses. This is evi[de]nced by 70.5% believing that there would be at least a little cost to their firm.”<sup>45</sup>

40. The NZIER study highlights the potential of BATs for SMEs. It underscores a fundamental positive attitude towards commercial arbitration as well as the need for national legislators to thoroughly prepare their business community to the effects of a BAT prior to its implementation. Similar studies in various other parts of the world would allow a more accurate assessment of the attitudes and expectations of SMEs towards BATs, and the ability of BATs to enhance international trade and commerce.

#### *IV. UNCITRAL, the Promulgation of a Model BAT and Issues for Further Consideration*

41. As observers noted during the 25-year anniversary of the UNCITRAL Model Law, UNCITRAL is “concerned with whether national laws are getting in the way of doing business effectively or where an absence of laws is creating uncertainty.”<sup>46</sup> As shown above, the current default system of international commercial dispute resolution relies on disparate national procedures with few unifying international mechanisms, creating substantial impediments to effective and efficient international commerce.

42. UNCITRAL is the flagbearer of fostering international trade and investment through, among other things, the harmonization and modernization of the law of dispute resolution. The Model Law together with the New York Convention and the UNCITRAL Arbitration Rules have been described as the principal pillars in the global system of arbitral justice.<sup>47</sup> The work of experts from more than fifty countries and numerous international organizations, these instruments represent consensus on international best practices.<sup>48</sup> Their success has exceeded expectations.<sup>49</sup>

43. Developing a Model BAT would be a natural evolution of UNCITRAL’s previous efforts. UNCITRAL instruments “are negotiated through an international process involving a variety of participants, including member States of UNCITRAL, non-member States, and invited intergovernmental and non-governmental organizations,” leading to wide acceptance and “solutions appropriate to different legal traditions and to countries at different stages of economic development.”<sup>50</sup> No other institution offers a comparable process and it would be ideal for a Model BAT to be designed on this basis.

44. Certainly, a BAT is innovative and breaks the mold of the current system of international dispute resolution. But, as the discussion in this paper demonstrates, it is not a change of direction to what exists today. Rather, it is a continuation of a successful path that UNCITRAL has pursued since its inception. It is natural that such an innovation will at first be met with scepticism, but it ought not to be forgotten that the New York Convention would have been of equal novelty 100 years ago. A BAT might at first glance seem new and unorthodox, yet, it promises similar benefits to the New York Convention, the UNCITRAL Model Law, and the UNCITRAL Arbitration Rules.

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<sup>45</sup> New Zealand Institute of Economic Research (NZIER), *Evaluating the proposed Bilateral Arbitration Treaty*, 25 February 2016, at p. 5.

<sup>46</sup> Timothy Lemay and Corinne Montineri, “Review of the Model Law’s Implementation after Twenty-Five Years”, in Frédéric Bachand, Fabien Gélinas (eds.), *The UNCITRAL Model Law After 25 Years: Global Perspectives on International Commercial Arbitration* (2013), JurisNet, at p. 3.

<sup>47</sup> See Timothy Lemay and Corinne Montineri, “Review of the Model Law’s Implementation after Twenty-Five Years”, in Frédéric Bachand, Fabien Gélinas (eds.), *The UNCITRAL Model Law After 25 Years: Global Perspectives on International Commercial Arbitration* (2013), JurisNet, at p. 4.

<sup>48</sup> See Timothy Lemay and Corinne Montineri, “Review of the Model Law’s Implementation after Twenty-Five Years”, in Frédéric Bachand, Fabien Gélinas (eds.), *The UNCITRAL Model Law After 25 Years: Global Perspectives on International Commercial Arbitration* (2013), JurisNet, at p. 5.

<sup>49</sup> See Timothy Lemay and Corinne Montineri, “Review of the Model Law’s Implementation after Twenty-Five Years”, in Frédéric Bachand, Fabien Gélinas (eds.), *The UNCITRAL Model Law After 25 Years: Global Perspectives on International Commercial Arbitration* (2013), JurisNet, at p. 4.

<sup>50</sup> United Nations Commission on International Trade Law (UNCITRAL), *A Guide to UNCITRAL* (2013), at p. 1.

45. Paying some heed to potential sceptics, the following part of this paper will outline the likely objections to BATs, highlight why these “buts” to the idea of BATs are unconvincing and provide a blueprint for areas of research that could be further explored by a broader community of academics, practitioners, and governments within UNCITRAL, with the aim of developing a Model BAT.

#### A. Consent

46. The most obvious objection to BATs crystallizes on notions of party autonomy and consent. Arbitration is deeply rooted in party autonomy<sup>51</sup> and arbitration is routinely said to be based on the consent of the parties involved.<sup>52</sup>

47. First, a BAT is in no way inconsistent with notions of party autonomy. As discussed above, the BATs’ arbitration mechanism is a default mechanism, which parties are free to contract out of. This can be accomplished by agreeing to alternative forms of dispute resolution (e.g., a forum selection clause or a provision for a particular form of institutional (or *ad hoc*) arbitration). Alternatively, as with the Convention on the International Sale of Goods, parties could simply opt out of the BAT-provisions entirely, without specifying any alternative form of consensual dispute resolution mechanism.

48. In this sense, a BAT does not compromise party autonomy. Commercial parties remain free to contract for whatever form of dispute resolution they desire (or to simply opt out of the BAT). The BAT merely changes the default form of dispute resolution if parties do not exercise their autonomy.

49. Second, it is true that a BAT results in arbitration without the historic form of consent to arbitration, but this is not a basis for objection to the BAT’s dispute resolution mechanism: the benefits of arbitration also exist where arbitration is used as a default means of dispute resolution, absent party consent, for international commercial disputes. Moreover, there is a substantial argument that the BAT arbitration mechanism is more consistent, not less consistent, with commercial parties’ expectations than the current default means of resolving international disputes.

50. The traditional view is arbitration is founded on consent: “[w]ithout an arbitration agreement there can be no arbitration.”<sup>53</sup> In commercial contexts, this arbitration agreement typically takes the form of contractual provision in a negotiated (and written) commercial contract between two (or more) companies. On the face of it, arbitration under a BAT operates without express party consent and therefore appears to run afoul of party autonomy. This might be seen as a radical departure from the status quo: a party that has not chosen arbitration — might not have even considered the possibility of arbitrating future disputes — will be compelled to arbitrate nonetheless.

51. However, a closer analysis demonstrates these concerns are misplaced. Although international arbitration has historically been based on contractual arbitration agreements, its benefits can be realized even in the absence of a traditional arbitration agreement. In particular, the benefits of efficiency, expertise, even-handedness and enforceability that result from international arbitration apply equally to arbitration pursuant to a BAT.

52. Put differently, international arbitration pursuant to a BAT provides a better default means of dispute resolution — even absent party consent — than the existing default system of cross-border litigation in national courts. Arbitration is used in other contexts (such as bilateral investment treaties<sup>54</sup> and many domestic contexts involving mandatory arbitration regimes<sup>55</sup>) without the requirement for party consent,

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<sup>51</sup> See Andrea Marco Steingruber, *Consent in International Arbitration*, OUP 2012, at para. 2.04 et seq.

<sup>52</sup> See Gary Born, *International Commercial Arbitration*, Kluwer Law International 2014, at p. 229.

<sup>53</sup> Simon Greenberg, Christopher Kee, J. Romesh Weeramantry, *International Commercial Arbitration: An Asia-Pacific Perspective*, Cambridge University Press 2011, at p. 21.

<sup>54</sup> See Rudolph Dolzer and Christopher Schreuer, *Principles of International Investment Law*, 2<sup>nd</sup> edition, OUP 2012, at p. 7.

<sup>55</sup> See e.g. Queensland Gas Pipeline Access Act, s. 15(1) (providing for mandatory arbitration). See also California Civil Procedure Code, §1141.10 and New South Wales Supreme Court Act 1970, s. 76B (providing for court



and there is no reason that arbitration could not be used effectively in the context of international commercial disputes.

53. Moreover, BATs arguably align more closely with the intentions of commercial parties than the current system of international dispute resolution. If one asks international businesspeople how their commercial disputes should be resolved, they would no doubt say that they would want a resolution that is expert, efficient, even-handed and enforceable. This is the very premise of a BAT.

54. Once States enter into BATs, they could (and indeed should) take steps to ensure that the businesses located in their territory are aware of the BAT's provisions and mechanisms. This would include outreach through chambers of commerce, trade and bar associations, public informational programs and the like. As such, by choosing not to opt-out of BATs parties are arguably indicating their consent (and satisfaction) with the default regime in BATs. This argument is only strengthened over time as parties become more aware of BATs and the arbitral process provided therein.

55. The issue of consent is ripe for further research and would provide a good starting point for UNCITRAL to commence its study on BATs. UNCITRAL could look to the work of various arbitral institutions in recent years that have had to address the question of party consent in increasingly attenuated ways when developing new procedural techniques such as the consolidation and joinder of parties, the role of non-disputing parties and the tribunal's powers in relation to third party funders.

### *B. Access to Justice*

56. Another obvious counter-argument to BATs relates to "access to justice." One might point to violations of constitutional guarantees that stem from BATs (e.g. the due process clause or right to a jury trial in the US Constitution<sup>56</sup> or Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms (the "ECHR")). However, this concern ignores the difference between access to *courts* — by no means a guarantee — and the more fundamental right of access to *justice*. Access to independent courts is a more compelling point in the domestic context.

57. In this international context, default arbitration under BATs arguably provides better access to *effective* justice than the current system of international litigation.<sup>57</sup> As the European Court of Human Rights noted in *Bellet v France*: "For the right of access to be effective, an individual must have a clear, practical opportunity to challenge an act that is an interference with his rights."<sup>58</sup> In light of the many shortcomings of international litigation<sup>59</sup> — parallel proceedings, lengthy procedures at a high cost and often unenforceable judgments — access to national courts is *not* a suitable realization of access to justice for international disputes. Neutral, efficient, objective, expert and fair arbitration under a BAT, on the other hand, is a realistic avenue to *effective* justice.

### *C. Arbitral Procedure*

58. Finally, one might wonder what the arbitral procedure under a Model BAT would entail. Some of the specifics a Model BAT might address are the scope of its application, the seat of arbitration, the arbitral process, whether to include pre-arbitration steps such as mandatory mediation and negotiation, rules on

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ordered arbitration).

<sup>56</sup> See The Constitution of the United States, Article III and the Fourteenth Amendment.

<sup>57</sup> See Petra Butler and Campbell Herbert, "Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty", New Zealand Universities Law Review Vol. 26, 2014, at p. 195 et seq. for an analysis of New Zealand law.

<sup>58</sup> ECtHR, *Bellet v France*, Application no. 23805/94, 4 December 1995, at para. 36; compare also *Äärelä and Näkkäläjärvi v Finland* (24 Oct 2001) Comm. No. 779/1997 (Human Rights Committee) in regard to Art 2 ICCPR.

<sup>59</sup> See above.

confidentiality or transparency and on judicial intervention and enforcement of awards rendered under the BAT.<sup>60</sup>

59. One of the authors has previously suggested that a Model BAT could adopt the revised 2010 UNCITRAL Arbitration Rules as the basis for conducting arbitrations under the BAT. The UNCITRAL Arbitration Rules are a neutral and modern set of arbitration rules<sup>61</sup> that provide default solutions for all key issues that arise when conducting an arbitration. In fact, it is already common practice to conduct international commercial arbitrations based on nothing more than reference to the UNCITRAL Arbitration Rules — no arbitral seat, no appointing authority, no additional procedural rules, and no choice of substantive law is necessary to successfully resolve such disputes.

60. Drafters will have to comprehensively assess the reasons for and against of including more detailed rules in a Model BAT. On the one hand, States might have strong interests such as certainty to include more detailed provisions on how arbitration should be conducted under their BAT. On the other hand, more detailed rules will detract from the universal appeal of a Model BAT and diminish its harmonizing effect on international commercial law.

61. One area that warrants particular attention when considering a Model BAT is the conflict between confidentiality and transparency. Confidentiality is not inherent in arbitration but it is common for parties to agree on confidentiality in their arbitration agreement or by their choice of arbitral rules.<sup>62</sup> Some States might want to provide for default transparency in the BATs they conclude. Possible reasons for this include the continued development of a body of accessible law, as well as a general interest in transparency.<sup>63</sup> UNCITRAL could explore how to balance these competing interests in a Model BAT, for instance, by providing for the publication of certain categories of awards relevant to the development of the law, and even then in a redacted fashion, or by providing incentives to parties that agree to the publication of their awards, such as subsidized tribunal fees.

#### D. Other Issues

62. Apart from the issues raised above, BATs raise various other points of academic and practical interest that are worth exploring. To name a few: Will States be comfortable with the extent to which default arbitration will result in the privatization of international legal decision making? Are BATs consistent with constitutional principles of separation of powers? What is the perspective of economic analysis of law on the proposal of BATs? Can empirical studies further illuminate the economic benefits and costs of BATs, especially for currently disadvantaged market participants such as developing small States and SMEs?<sup>64</sup> What lessons can be drawn from behavioural economics to design default arbitration as an opt-out mechanism? How would a BAT intersect with existing instruments of arbitration law, including national arbitration laws and the New York Convention?

63. The authors hope that through a study of BATs there will be a robust discussion of such issues, both within the institutional setting of UNCITRAL and beyond.

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<sup>60</sup> See Draft Commentary on Model Bilateral Arbitration Treaty, [https://www.wilmerhale.com/uploadedFiles/Shared\\_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf](https://www.wilmerhale.com/uploadedFiles/Shared_Content/Editorial/News/Documents/Explanatory-Note-Draft-Model-Bilateral-Arbitration-Treaty.pdf) (last accessed on 29 November 2016); see in regard to New Zealand: Georgia Whelan “Could a BAT fly? An Evaluation of the Proposed Bilateral Arbitration Treaty in the New Zealand Context, 2017 Victoria University Law Review [forthcoming].

<sup>61</sup> See Matthew Skinner, Sam Luttrell, Tom Levi, “The UNCITRAL Arbitration Rules 2010”, in 7 Asian Int’l Arb. J. 76, 76-96 (2011), at p. 95.

<sup>62</sup> See Nigel Blackaby, Constantine Partasides, *Redfern and Hunter on International Arbitration*, 16th edition, OUP 2015, at para. 2.161.

<sup>63</sup> See for example the debate on transparency in ISDS and the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (or “Mauritius Convention”).

<sup>64</sup> For instance, Victoria University of Wellington and the New Zealand Institute for Economic Research have jointly commenced such empirical research on BATs, including to identify the benefits BATs offer SMEs. UNCITRAL may wish to collaborate with these and other institutions on the empirical aspects of implementing BATs.

## *V. Conclusion*

64. The current default system of international commercial litigation does not meet the needs of contemporary cross-border trade and investment. Bilateral arbitration treaties are a solution that would enable more efficient, more expert, more neutral, more objective, and more fair dispute resolution. BATs would make these benefits available to more market participants, including small States and States with developing economies, as well as SMEs. As a result, BATs would enhance international trade and investment, access to justice and the rule of law in international commercial settings.

## *Session 11 — Implementing the Convention on Contracts for the International Sale of Goods*

### *How 'International' Is International Commercial Law? Key Findings of UK Research<sup>1</sup>*

*Mary Wallace, University of East Anglia School of Law, United Kingdom*

#### *1. Introduction*

The primary aim of the research work was to establish whether a particular culture has developed within the selected groups, in response to international instruments of commercial harmonisation and if so, what had informed this approach.

From the research undertaken, it is apparent that the approach of all has been characterised by competing tensions between 'the national' and 'the international' and between the shared ideal of international instruments and the application of national laws. Moreover, the tensions evident in one institution or group have also been found to influence the approach to international instruments of others. Therefore, it cannot be said that each has a distinct and individual culture; rather there are inter-related cultures which have been informed by the complex inter-relationship between the different institutions and groups.

#### *2. The Universities*

Within university Law Schools, despite subjects being variously described as 'International Trade Law' or 'International Commercial Law', it is English sales law which is generally taught at undergraduate level as the applicable law for international sales.

This at first appeared to be a consequence of the Practitioners' Regulating Authorities setting the six 'foundation subjects' as prerequisites for a Qualifying Law Degree; but on closer inspection there remains scope for universities to offer international content within undergraduate commercial law subjects, at least within the LLB Degree Programme. Despite this, only 15% of universities include detailed study of international conventions which have not been incorporated into English law, and whilst a further 45% of law schools include a brief introduction to rules such as Incoterms, it means 40% of universities in England and Wales do not include *any* international content within commercial subjects at undergraduate level. This means that many graduates enter commercial practice with knowledge solely of English law.

Nevertheless, there is some tension between 'national' and 'international' within law schools, as some 80% offer LLM Courses in 'International Commercial Law' (including some law schools who do not offer any commercial law at undergraduate level). This tends to suggest that universities have developed a culture which treats international commercial law as a postgraduate academic subject rather than as a potentially applicable law for cross border transactions. This culture appears to be strongly influenced by financial considerations as postgraduate courses with international content attract high fee paying foreign students. It should also be noted that postgraduate law studies are outside the reach of the practitioner regulating authorities and therefore the law schools are able to wholly set their own curriculums.

#### *3. The Practitioners*

The University culture that has developed is also supported and reinforced by Practitioners and their firms. It was found that commercial firms are willing to accept trainees with little or no knowledge of

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<sup>1</sup> This paper presents the key findings from a thesis submitted in respect of the Degree Doctor of Philosophy at University of East Anglia School of Law in 2012 entitled 'Instruments of International Commercial Harmonisation in England and Wales: How 'International' is International Commercial Law?' The complete thesis is available at [https://ueaeprints.uea.ac.uk/47955/1/WALLACE-Ph\\_D\\_THESIS\\_FINAL.pdf](https://ueaeprints.uea.ac.uk/47955/1/WALLACE-Ph_D_THESIS_FINAL.pdf).

commercial law beyond a simple ‘awareness’ and certainly no knowledge of international commercial laws. Consequently, there is no vocational need for students entering commercial practices to have any concept of international commercial instruments and this must impact on the culture and attitudes that these individuals develop towards such instruments going forward.

Given that 90% of commercial cases handled by London law firms involve an international party<sup>2</sup>, it was not surprising that 92% of the international law practitioners responding to the research questionnaire had advised on international commercial rules or practices, such as Incoterms or UCP600 and regularly incorporated them into contracts. However, when it came to whether a practitioner would recommend a **convention** such as the CISG where it would be applicable to the situation, the approach was somewhat different. Although 34% had been asked to advise on the CISG nearly half of these practitioners stated they would *not* recommend clients incorporate this convention into sales contracts, and some routinely recommended the CISG should be expressly excluded. The questionnaire responses also highlighted some misunderstandings held by practitioners as to the CISG’s applicability and/or provisions — with some stating ‘the CISG was not law’ or that the CISG ‘must be ratified in the place of actual performance’ in order to be applicable.

There was a general perception amongst the practitioners surveyed that English law is adequate for cross border transactions and therefore there was no need for international conventions. In fact, the superiority of English law was given by practitioners as a reason to recommend the CISG’s *exclusion* from contracts, as English law was “the accepted basis for international sales contracts, given it has an established reputation for legal certainty, fairness and transparency”<sup>3</sup>.

Arguably, it is the reputation of English law which brings commercial cases to the courts and arbitral tribunals in London, even when the parties have no connection with the UK<sup>4</sup>, so the Practitioners’ approach is also based on the fact that English law is not only a governing law but has also effectively developed into an industry — an industry which Practitioners are keen to protect.

#### 4. Government/Parliament

Government and Parliament are also keen to promote and protect this legal industry, given the revenue it generates, and it is this sense of protectionism which appears to be at the crux of the culture that has developed within Parliament and Government towards international commercial conventions.

This culture of protectionism is evident from the complex justification process for ratifying commercial conventions. English constitutional law requires an Act of Parliament to incorporate a convention into English law but the research has shown that international private law is not high on Parliament’s legislative priority list. This is clearly reflected in the fact that international commercial conventions and protocols have in the main required Private Members’ Bills for their introduction rather than being introduced into Parliament as a Public Bill. Furthermore, enabling legislation to pass international commercial conventions and protocols into English law has always had to compete against the social issues and economic policies of the day, so lack of parliamentary time is often cited as a reason for a convention’s non-ratification<sup>5</sup>. However, it is interesting to note that during the research, Parliamentary time had been allocated to bills as diverse as ‘Keeping Primates as Pets’, ‘Caravan Sites’, ‘Food Waste’ and ‘Snow Clearance’ — so as Sir Roy Goode as commented some years ago, the excuse of lack of Parliamentary time “wears a little thin after 20 years”<sup>6</sup>.

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<sup>2</sup> Ministry of Justice & UK Trade and Investment, ‘Plan for Growth: Promoting the UK’s Legal Service Sector’ (2011).

<sup>3</sup> Quote from questionnaire response.

<sup>4</sup> See for e.g. *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141 (HL) per Dilhorne LJ at 162.

<sup>5</sup> See Sally Moss, ‘Why the United Kingdom has not Ratified the CISG’ 25 J.L. & Com. 483 2005-2006, p. 483.

<sup>6</sup> R.M. Goode, ‘Insularity or Leadership: The Role of the United Kingdom in the Harmonisation of English Law’ (2001) 50 Int’l. & Comp. L. Q. 756.

Moreover, in other areas of law, such as human rights or public international law, laws have become internationalised in the UK almost without question, but it is apparent from the research that Parliament has a sense of reluctance for legislating on international private law matters and that tensions exist between making laws and protecting freedom of contract. For instance, it took some 42 years from 1882 to 1924 before Parliament, as a result of an international convention, placed uniform bills of lading on the statute books, and even then, Parliament still showed signs of being averse to legislative interference with the contractual autonomy between merchants and carriers.

These factors may account for the culture of reluctance that has developed within these institutions to enacting the requisite legislation to bring international conventions such as the CISG into domestic law, as these would arguably compete against ‘the English legal industry’.

## 5. *The Judiciary*

However, even when international conventions have been ratified there are still competing tensions between ‘international’ and ‘national’ laws when they come to be interpreted in the courts of England and Wales. Outwardly, there appears to be an ‘international’ view, with various judges emphasising the need for conventions to be “construed on broad principles of general acceptance” and not “rigidly controlled by domestic precedents of antecedent date”<sup>7</sup>; and other landmark cases have sanctioned the use of the *travaux préparatoires*<sup>8</sup> and the French text<sup>9</sup> of the Convention when interpreting convention provisions.

But the research has shown that such international sources have only been followed to the extent that it is possible to do so without impacting on the principles and concepts inherent in English law; and although there has been some uniformity with the decisions of other contracting states, it has usually been in cases where foreign judgments coincide with or are used in support of the approach taken by the English judiciary.

This approach has arguably allowed the judiciary to effectively develop its own method of interpreting international commercial conventions and whilst this approach has allowed the judiciary to minimise the effects of international commercial law, it has perhaps tended to place conditions on the overall objective of international conventions, being uniformity.

## 6. *The Traders*

Finally, in the case of the traders, the group that international commercial instruments were developed to assist, the research showed that whilst most were familiar with rules and practices such as Incoterms and the UCP; in respect of international conventions, their approach was largely one of ignorance.

96% of the traders responding to the research questionnaire did not know of the CISG’s existence as an alternative to English law and during follow-up interviews, the majority stated that the international contract provisions of the CISG were ‘a good idea’. Moreover, 15% stated that, had they been aware of the CISG, they may have voluntarily contracted on its terms, as they had experienced difficulties establishing international sales contracts with new buyers in new markets areas, due to differences in legal regimes.

Most of the traders stated during interviews that they relied on information on cross-border sales contracts supplied by legal advisers, freight forwarders and government international trade websites, and this again demonstrates again how cultures that have developed towards international commercial instruments in one particular institution or group influence and inform the approach of others. The approach of Practitioners would suggest that it would be English law that would be recommended if legal advice was sought by a trader and the ‘International Commercial Contracts’ section within the government’s international trade website contains only information on Incoterms — there is no information on other potentially applicable sale of goods laws such as the CISG.

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<sup>7</sup> *Stag Line Ltd v Foscolo Mango & Co Ltd* [1932] AC 328 (HL) per Lord MacMillan at 350.

<sup>8</sup> *Fothergill v Monarch Airlines Ltd* [1981] AC 251 (HL).

<sup>9</sup> *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141 (HL).

Consequently, in the cross-pollination of approaches some of the international commercial conventions, which were developed to overcome specific impediments to international trade, are not being used by the very merchants they were intended to benefit and in some cases traders are not even aware of their existence. That is not to assume that traders would necessarily use international conventions by choice even if they were aware of them, as such use would perhaps also necessitate overcoming the culture that the traders appeared to have to contracts in general — whether offer and acceptance match perfectly is less of a problem for instance, than how and when delivery will be effected until such matters are in dispute. This then raises the issue as to whether international commercial instruments are developed for the needs of traders or for the legal needs of practitioners, and whether the ‘needs’ of the two institutions are ever resolved by one instrument, but this is beyond the scope of this particular research.

## 7. Conclusion

The insular approach that the institutions and organizations studied have developed in relation to international commercial law, conflicts with the global image that each strives to portray. For example, Government departments<sup>10</sup> promote and support international trade as a major contributor to the economy; most universities in England and Wales promote their international perspective and there has been a growth in the number of large co-called ‘international’ law firms (both those indigenous to the UK and US law firms establishing London offices) — to the extent, that a senior partner in Clifford Chance stated that he did not feel bound so much by the ethics or rules of conduct of the Law Society of England and Wales, but by international codes which more clearly affect their transnational and international business<sup>11</sup>. Consequently, although there may be a fear of international commercial instruments it is perhaps not caused by an overriding fear of globalisation as such.

However, there is clear evidence within the institutions and groups studied, that a distinct culture has developed towards international commercial instruments. At its basis is the tension between ‘international’ and ‘national’ law; and an apparent need to protect English law. Moreover, there is an overriding sense that international instruments are used as a means of better fitting English law to cross-border transactions; rather than applying such conventions as an alternative to or in preference to English law. So rather than international commercial law there is, in essence ‘internationalised’ national law.

In order to minimise the reliance solely on domestic law there must be changes in the culture that has developed towards international commercial conventions. For this to happen, two potential solutions can be identified. Firstly, law schools need to ensure that international alternatives to English law are included within undergraduate commercial law subjects, as introducing the CISG, for example, to the next generation of practitioners is perhaps a better approach than trying to alter long-held perceptions that national is best.

Secondly, rather than conventions which require government ratification and legislation to formally enact them into national law, perhaps the way forward is the development of recommended international rules or practices by the trading sector to overcome specific issues in cross border trade. It is perhaps not a coincidence that the groups studied were more familiar with rules such as Incoterms and the UCP, whilst many were unaware of the international conventions, so more analysis needs to be undertaken as to the type of international instruments that are used to harmonise commercial law.

Thus, rules and practices developed by the international trade sector, would be approved and used by the international trade sector without requiring government or parliamentary intervention, and in doing so a new *lex mercatoria* may emerge. This could potentially enable more effective and greater harmonisation of commercial laws and may also help overcome the cultures that have developed in respect of the existing international commercial instruments.

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<sup>10</sup> Such as UK Trade & Investment (UKTI).

<sup>11</sup> Avrom Sherr, ‘Globalization and the English Judiciary’ (2001) p.8-9; Available at <http://sas-space.sas.ac.uk/259/>.

## *How Do You Mean It, CISG? Applying The CISG More “21<sup>st</sup> Century”-Way*

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### *I. Introduction*

The purpose of the CISG (United Nations Convention on Contracts for the International Sale of Goods) is to provide a modern, uniform and fair regime for contracts for the international sale of goods. Thus, the CISG contributes significantly introducing certainty in commercial exchanges and decreasing transaction costs. At the time of writing this study<sup>1</sup>, 85 contracting states are involved in this unification, including the most important trading partners of the world: USA, China, Japan, Russia, Germany, Australia. Although, some important countries are missing: from the EU Great-Britain, Portugal and Malta did not join the Convention so far, India and many African countries are also not on the list of contracting states.

The drafters of the CISG took special care in avoiding the use of legal concepts typical of a given legal tradition, and this method results from a deliberate choice to ensure that the Convention would promote harmonization of substantive law by the largest number of States, regardless of their legal tradition<sup>2</sup>. Schwenzer points out that the CISG achieved a symbiosis of common law and continental law, which will once more furnish jurists involved with sales law with the uniform language that is needed to pose questions and provide solutions<sup>3</sup>. As Flechtner says, the goal of the drafters was to create uniformity in the rules for international sales, in order to supplant the complex and difficult-to-predict system that subjected international sales to the varying provisions of national sales laws<sup>4</sup>.

During the formation and adoption of the CISG, Hungary was striving to play an active role in the unification of law right from the early sixties. Hungarian legal scholars and academics, based upon a century-old sophisticated legal culture, were never willing to accept the idea and reality of a divided world and their country's isolation behind what was called the Iron Curtain<sup>5</sup>. This was all the same by the other countries of the so-called “Visegrad-Four Countries” (V4)<sup>6</sup>, and as a proof of this, these countries joined the CISG among the first ones. The Convention entered into force on 1st January 1988 in Hungary, in the Czechoslovakia on 1st April 1991, the Czech Republic and Slovak Republic succeeded to the convention as of 1st January 1993. In Poland it came into force on 1st June 1996, so at least the Polish legal system is having more than 20 years of experience so far. These countries share almost the same (or at least very similar) legal tradition, as all based on the German law. It is not a surprise, that these counties are facing similar problems with the interpretation of the CISG articles<sup>7</sup>. With this I only want to sign that the difficulties occur in the Hungarian practice are not unique in this area. In spite of the time far enough for getting the experience, one may feel that in practice the CISG is not favoured for the contracting parties.

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<sup>1</sup> Manuscript closed on 4th January 2017.

<sup>2</sup> UN: UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods, New York, 2012 (hereafter: Digest 2012). ix. p.

<sup>3</sup> Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG), Oxford University Press, 2010. p. 6.

<sup>4</sup> Harry M. Flechtner: The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and other Challenges to the Uniformity Principle in Article 7(1) Journal of Law and Commerce, 1998/17. 187-217. 187.p.

<sup>5</sup> J. Martonyi: Introduction. In: Thirty-five Years of Uniform Sales Law: Trends and Perspectives Proceedings of the High Level Panel held during the Forty-eighth Session of the United Nations Commission on International Trade Law Vienna, 6 July 2015. United Nations, New York, 2015.

<sup>6</sup> The Visegrad Group (also known as the “Visegrad Four” or simply “V4”) contains of the Czech Republic, Hungary, Poland and Slovakia, which group reflects the efforts of the countries of the Central European region to work together in a number of fields of common interest within the all-European integration.

<sup>7</sup> I base this statement on the similar researches made in these countries during 2015, and were presented in Zagreb, on the international conference “35 Years of CISG — Present Experiences and Future Challenges” 1st December 2015.



According to the statistics of the UNCITRAL, in the CLOUT database there are only few cases reported from this area, although the contracting states are among the first ones to ratify the Convention.

## II. Empirical research on the jurisdiction of the CISG in Hungary

In 2015 with a questionnaire sent directly to the most significant international law firms, to the Hungarian National Chamber of Attorneys and to the Győr-Moson-Sopron County Chamber of Attorneys the process of drafting and entering of international sales contracts has been examined. Altogether 20 questionnaires were sent directly to major law firms, and through the Chambers approximately 150 attorneys has been asked to answer. As a result, 35 documents arrived until 31st August, 2015 from the whole country, among this 12 were the result of the directly requested offices, and 23 through the Chambers' request. At the same time, a parallel research has started in the judicial field. This way 150 questionnaires were sent directly to the Courts in Hungary, and parallel the National Office of the Judiciary sent the questionnaire via email to the heads of the Courts. From July to December of 2015, 49 questionnaires arrived with appraisable content. As the arbitration in commercial disputes is traditionally dealt by the Arbitration Tribunal attached to the Hungarian Chamber of Commerce and Industry, resident in Budapest, I also sent the questionnaire to the judges working here, and got only 1 answer back, but this one has clearly showed the difference between the state court's routine and the arbitration experiences. During 2015 and 2016 the judgements and arbitration awards from Hungary has been overviewed to get a wide insight of the practice of application of the CISG.

One result of the research was that many times CISG is an "accidental" part of the sales contract, as many contracts contains the clause that in case of any debates between the parties the Hungarian law should be applied, which — naturally — contains the CISG. In this case the parties are not necessarily aware of the fact that an international treaty has been incorporated into their contractual relation.

While an exclusion can have proper legal reasons based on well-considered facts and interests, it is reported in the international literature, that is often rather a "habit"<sup>8</sup>. The questionnaire also included a part on exclusion of certain legal regimes in the contracts, and the major law firms (dealing with more than 10 international sales contracts in a year) reported to exclude CISG from the following reasons.

Figure 1.

Reasons of excluding the CISG

<b>"Do you used to exclude the use of certain state's law or any other legal orders or conventions for the disputes?"</b>	<b>Reasoning or comment on exclusion</b>
"I exclude CISG for the request of the client"	<i>Comment:</i> "Fundamentally I have positive experiences. The Convention is easy to use for a continental lawyer, the Hungarian and foreign language (basically German) commentary literature is useful help. But at the same time during the civil procedure nor the judges nor the clients realize the need for applying the regulations of CISG, they have to be noticed on this fact during the process."
"I exclude CISG."	<i>Reasoning:</i> "In case of international sales contract in many concrete cases it is favourable

<sup>8</sup> For the United States' practice see: Martin F. Koehler: Survey regarding the relevance of the United Nations Convention for the International Sale of Goods (CISG) in legal practice and the exclusion of its application (October 2006). Available: <http://www.cisg.law.pace.edu/cisg/biblio/koehler.html> (as on 4th January 2017). A perfect international comparison is available by Lisa Spagnolo: Green Eggs and Ham: The CISG, Path Dependence, and the Behavioural Economics of Lawyer's Choices of Law in International Sales Contracts. *Journal of Private International Law*, 2010/2. pp. 417-464.

	for the seller using only the Hungarian law. Without direct excluding of the Vienna Convention it must be applied, and as the Convention do not govern all relevant field, in disputes this doubles the applicable laws what may lead to a confusion in the judgement". <i>Comment:</i> "The main problem of the Convention is the lack of uniform application which is the result of the phenomena that the national courts interpret the Convention based on national laws."
"I exclude CISG almost all the time"	<i>Reasoning:</i> "The Convention is not accepted in the international practice for many reasons, almost every time the applicability is excluded"
"I exclude CISG"	<i>Reasoning:</i> "The application of the CISG is internationally rare"
"If the client is the seller, I exclude CISG"	<i>Reasoning:</i> "The Hungarian civil law is more in favour of the seller in particular situations."
"The clients expressing the will for excluding the CISG"	<i>Comment:</i> "Despite of the fact that the Convention' regulations are clear, the Courts have inconsistent practice of interpretation, or simply do not use the Convention tough it is mandatory in the process."

As we can see some of the legal representatives feel that there is no uniform or consistent interpretation of the CISG in Hungary, or even sometimes knowledge of the CISG and its mandatory application for international sales contracts. The research also identified the phenomena of being totally unaware of the presence of the CISG among the judicial board. Among the 49 answers coming from judges who are dealing with at least 1 case a year on international commercial law, 32 (which means 65,3% of the answerers) has never met the CISG during his/her practice! This result is shocking. It is even more that, if we take into consideration the fact that (living in the 21<sup>st</sup> century) hundreds of cases are available in full or in forms of abstracts on the internet. Here I would like to highlight the efforts of UNCITRAL<sup>9</sup> and Pace Law School<sup>10</sup> on publishing as much cases as possible, but we can also mention several national compilations on national case law<sup>11</sup>. So the basic problem is for sure not the accessibility of scientific materials, we should search the answer elsewhere.

Lisa Spagnoli summarizes among the CISG-familiarity issues that it is a combination of three elements determining the learning costs of a lawyer in a particular jurisdiction: (1) educational coverage and imperative (2) extent of dispute work exposure and (3) whether the domestic law has been influenced by the CISG. Let's see the case of Hungary: for (1): we can say that the CISG is a mandatory course under the subject of "Private International Law" in every law school of the country. In this aspect, Hungary has got some hope for the future. Bur for element (2) we are facing a lack of frequent dispute work: only one commentary with relevant case law cited has been published on the CISG in 2006<sup>12</sup>, and ever since only one or two scholars<sup>13</sup> are writing sometimes on the subject of international sales law. As for element (3) of

<sup>9</sup> Especially the CLOUT collection, which is well-designed, easy to use platform.

<sup>10</sup> A unique collection of case law and scientific articles are also available. I believe that this site (<http://iicl.law.pace.edu/cisg/cisg>) is the role model for every institution working on international commercial law issues.

<sup>11</sup> E.g.: CISG France, founded by Prof. Claude Witz ([www.cisg.fr](http://www.cisg.fr)), and CISG Slovakia, a database created by the Department of International Law and European Law at the Faculty of Law of the Trnava University in cooperation with Institute of International Commercial Law at the Pace University School of Law. ([www.cisg.sk](http://www.cisg.sk)).

<sup>12</sup> Sándor, Tamás-Vékás, Lajos: Nemzetközi adásvétel. HVG ORAC, Budapest, 2006.

<sup>13</sup> Mostly Sarolta Szabó is publishing researches, her best known book is: Szabó, Sarolta: A Bécsi Vételi Egyezmény, mint nemzetközi lingua franca — az egységes értelmezés és alkalmazás újabb irányai és eredményei. Pázmány Press, Budapest, 2014., and the author of this research is try hard to promote the CISG.

Spagnoli we have to see that the Hungarian civil law has its roots in the Roman law, and during its formation basically influenced by the German and Austrian legal tradition, namely by the BGB and the ABGB. It is also agreed, that Italian and French legal influence also can be detected in our private law.<sup>14</sup> We also have to consider when examining the international influence on the Hungarian civil law that the EU's mandatory regulations on the field of international private law has also formed the codification process<sup>15</sup> started in the late 1990's, and ended in a new Hungarian Civil Code. When examining the similarities and differences in regulation the sales contract in the CISG and the Hungarian Civil Code we have to make difference in the case law before and after the new Hungarian Civil Code, Act V of 2013, came into force on 15<sup>th</sup> March, 2014. The Commentary on the new Hungarian Civil Code has referred to the CISG as follows: "Despite of the straightening of sales contract as a fundamental contract type the regulation cannot be unified on it as Hungary is contracting party of the CISG. In cases where the CISG is applicable, the Hungarian Civil Code must be set aside. Although the Civil Code aspired to implement the effective regulations of the CISG, it could not be the goal to introduce regulations perfectly fitting to international sales law to be applied for national sales contracts. The duplicity stays: Hungarian Civil Code for national sales contracts, and the Convention as autonomous law for international sales contracts"<sup>16</sup> According to the codifiers upper note, the regulation is expressly divided from the international influence of the CISG. This way, we can say Hungary failed the third criteria of Spagnoli as well.

### III. Language obstacles of uniform interpretation

I made an analysis on the CLOUT database setting the language issues in front. The CISG has been made on 6 official languages: Arabic, Chinese, English, French, Russian and Spanish, and among these the English, the German and the Spanish are spoken more frequently on international field of commerce. If we collect the countries from which the most referred cases came from, we see an interesting picture in comparison with the law-level language speaking counties like the V4.

Figure 2.

Number of cases in the CLOUT by countries and languages<sup>17</sup>

Official language	Country	Number of cases on CLOUT
German	Germany	218
	Austria	63
	Switzerland	100
English	USA	121
	Canada	161
	Great-Britain and Northern Ireland (not even contracting parties of the CISG)	16
	Australia	50
French	France	75
Spanish	Spain	126
/other than the official languages of the CISG/	Hungary	15
	Poland	26
	Check Republic	3
	Slovakia	2

The fact that the Convention is also available in Spanish, as one of the six official United Nations languages, facilitates interpretation of the Convention even for Latin American countries, in the majority of

<sup>14</sup> Ádám Boóc: Észrevételek az új Polgári Törvénykönyv tervezetéhez nemzetközi magánjogi szempontból. In: Polgári Jogi Kodifikáció, 2008/3., pp. 3-8. 3.p.

<sup>15</sup> Gábor Palásti: Közrendi, imperatív, kógens és diszpozitív szabályok. In. Magyar Jog, 2006/2. pp. 65-77.

<sup>16</sup> Osztovits, András (szerk): A Polgári Törvénykönyv magyarázata. Vol. II. 1702.p.

<sup>17</sup> As published on the UNCITRAL website on 4th January, 2017.

which the language is Spanish, and helps to create a uniform case law, which will not be enjoyed by those countries of the Americas that have not yet adopted the Convention<sup>18</sup>.

I would like to highlight German and English because one other reason, which is the available scientific literature. Most of the materials written on CISG and its jurisprudence or interpretation is basically in English or German<sup>19</sup>. Here we have arrived to the next level of obstacles: the lack of knowledge of the relevant case law. Although in the previous point I highlighted that the internet makes hundreds of cases available, but most of these cases are published or available in English, so the language issues occur here: not only should a lawyer/judge/arbitrator be familiar with another language, but he/she must be familiar with another language's legal terminology. And here we have reached the point of the disadvantage of the different legal cultures. As Harry M. Flechtner is analysing in one of his work, the legal instruments are not easy to translate<sup>20</sup>, and even more difficult between different legal traditional backgrounds. Should we blame our judges when their failing this challenge? I do not think so. According to the official statistical report of the Hungarian National Office for the Judiciary in county Győr-Moson-Sopron under the 19 judges dealing with civil law 4866 cases has been started in 2015, which means (proposing an equal working pressure on them) every single judge has seen 256 cases in a year, more than 21 new cases in a month. And they have reported in 2015 that in a year they meet 1-5 international commercial cases. Is it a surprise that they do not have the time (and/or the motivation) to follow the international case law on CISG, or read the relevant international legal literature?

Among the language issues we should mention, that in Hungary nobody can get a diploma (not even a bachelor's degree) without at least one foreign language exam (both oral and written) with medium level. In Hungary the most frequently spoken languages are German and English (how lucky, we could believe according to the literature of the CISG...). To sum up: all of our judges in Hungary have — at least an official paper on — language knowledge, so theoretically this should not be an obstacle for reaching the relevant literature. Theoretically.

#### IV. Measures to make for a more uniform interpretation and better understanding of the CISG

If we are looking at the court decisions from the V4 countries (not taking into consideration the arbitration courts, which are different in many aspects), most of them simply do not cite any international case law, nor international literature while applying the CISG in a case. This leads to the sad fact, that Article 7 (1)'s mandatory rule of autonomous and international interpretation of the Convention will remain a mere principle. According to the upper mentioned empirical survey among the reasons of lack of knowledge on international case law the Hungarian judges mentioned the absence of domestic (i.e. Hungarian language) literature on the subject. We should admit that it is not an application condition for a domestic judge to be perfect English- or German-speaking (or reading) one, so it is not obvious to require from a judge being up-to-date with the international case law. However, we should find a resolution for this issue. As a good example, in the Netherlands there is a helping guide for the judges, so called "*Procureur-Generaal*". The *Procureur-Generaal* or his deputies the *Advocaten-Generaal* (Advocates General) deliver an advisory opinion (*Conclusie*) in all civil cases decided by the judge of the case. These advisory opinions play an important role in the development of the case law by the judges.<sup>21</sup> I see this solution as a best

<sup>18</sup> Ana Elizabeth Villalta Vizcarra: United Nations Convention on Contracts for the International Sale of Goods. In: Thirty-five Years of Uniform Sales Law: Trends and Perspectives Proceedings of the High Level Panel held during the Forty-eighth Session of the United Nations Commission on International Trade Law Vienna, 6 July 2015. United Nations, New York, 2015. 29-38.p. p.35.

<sup>19</sup> Without being biased, I would like to set the Schlechtriem & Schwenger commentary as a perfect example of the two dominant languages of scientific literature. This well-known and repeatedly updated commentary is published also on these two languages. See the German version: Schlechtriem & Schwenger: Kommentar zum Einheitlichen UN-Kaufrecht. Verlag C.H. Beck, München — Helbing Lichtenhahn Verlag, Basel, 6. edition, 2013.

<sup>20</sup> Harry M. Flechtner: The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and other Challenges to the Uniformity Principle in Article 7(1). Journal of Law and Commerce 1998/17. pp. 187-217.

<sup>21</sup> Sonja A. Kruisinga, The Impact of Uniform Law in National Law: Limits and Possibilities — CISG and Its

practice for national judiciary system, which should be highly recommended for contracting states. In the Hungarian system we can see a kind of version of this institution in the position of “high consultant of the Curia”, but this position only exists on the highest level of the judicial system. But cases occur first on the lower levels, so a solution can be to introduce these positions to lower courts as well.

The Széchenyi István University Faculty of Law and Political Sciences got a 10-month-funding from the Ministry of Justice of Hungary to start building a national database of the CISG cases — in Hungarian. This is the first time that an institution has a goal of collecting and translating (at least a part of) the existing case law on international sales. Part of the project is to publish relevant scientific literature in Hungarian as well. While creating this database the role model is the Pace Law School Institute of International Commercial Law and its method of dealing with the different issues of international commerce<sup>22</sup>. We believe that with publishing the relevant case law in Hungarian would enable the judicial staff to be more aware of the relevant interpretation issues.

Another key element to enhance the autonomous interpretation of the CISG is the legal education. When facing with the problem of the application of the CISG in the United States, several scholars got to the same point: if we want to be more familiar with the Convention, we should start with the education<sup>23</sup>. Dodge states, that teaching the CISG for USA students is fun, “because the CISG is different from both the common law and the UCC, and those differences provide wonderful opportunities to question the rules of contract law that we have grown so used to”<sup>24</sup>. But finding an ideal balance for international law subjects are not easy. Fatima Akkadaf raised the next question in 2001, which is still opened: “If international law is imperative, how do we ensure that students receive it?” She suggested to start including international and comparative law on the American bar examinations<sup>25</sup>. Although she declared this as a utopia for the United States, I deeply believe that this must be a reality for the contracting state’s law schools — not for the bar exams, but for the bachelor and master courses as well. How do we expect the proper use of the mandatory international conventions if we do not teach them properly for graduating lawyers? In this field I also believe that the UNCITRAL itself has got steps to take: for making the CISG more user-friendly, it has to be promoted for teachers, lecturers at the law schools as well. In my opinion it would be great to have teaching materials for CISG, and these materials can be a result of an international cooperation between scholars interested in international sales law. As a lecturer for more than 10 years now, I am sure that many of my colleagues has his/her own “best practice” for make this subject and the Convention more familiar with the students — so why not share the experience with each other? The Faculty in Győr is making the first step: we will publish our ways of teaching including teaching materials on the CISG in Hungarian, and plan to do the same in English for ERASMUS students.

We are also facing the problem of generational challenges. Not only we have to present our work and make it available in Hungarian: we have to do it on the “21<sup>st</sup> century way”. Student of today’s law schools are seeking for a different kind of education: less front presentations and lectures and more group work, more “learning-by-doing”, so the new teaching materials must fit to their new ways of learning as well<sup>26</sup>.

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Incidence in Dutch Law, vol. 13.2 Electronic Journal Of Comparative Law, (May 2009), p. 7, <<http://www.ejcl.org/132/art132-2.pdf>>. The institution is mentioned by the national report on CISG by Viola Heutger: National report of the Netherlands. International Conference “35 Years of CISG — Present Experiences and Future Challenges”, Manuscript, 2015. p. 10-11.

<sup>22</sup> See it here: <http://iicl.law.pace.edu/cisg/cisg> (as on 4th January 2017).

<sup>23</sup> see e.g. Kina Grbic: Putting the CISG Where It Belongs: in the Uniform Commercial Code. *Touro Law Review*, 2012/29. pp. 173-203. or William S. Dodge: Teaching the CISG in Contracts, *Journal of Legal Education*, 2000/1. Vol. 50. pp. 72-94.

<sup>24</sup> Dodge op.cit. p. 94.

<sup>25</sup> Fatima Akkadaf: Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?, *Pace International Law Review*, 2001/1. (Vol. 13.) p. 4.

<sup>26</sup> There are so many literature on the „y-generation”, and on „z-generation” and their special needs and preferences, here I only mention refer to an interesting research on Gen-Z’s expectations on higher education: Barnes & Noble College: Getting to Know Gen Z — Exploring Middle and High Schoolers’ Expectations for Higher Education. Available here: <http://next.bncollege.com/wp-content/uploads/2015/10/Gen-Z-Research-Report-Final.pdf> (as on 4th January, 2017).

The expectations of the new generations include “educational technology” available, so creating online educational tools are one step towards getting more young law students (future lawyers) to get to know the CISG better.

According to the Tao Te King “a journey of a thousand miles begins with a single step”. The Széchenyi István Faculty of Law and Political Sciences, Department of Public and Private International Law is making this first step these days. We truly believe that promoting the CISG has to start with the legal education, and efforts must be made to translate the international case law to Hungarian language to make it available for practicing lawyers and judges. The goal of unanimous and international interpretation of the CISG in Hungary (and I think in many countries) will remain a dream unless we fulfil at least two criteria of Lisa Spagnoli: educational coverage and extension of dispute work exposure.

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## *The Adoption of the CISG in Iran: Practical Difficulties in Implementing the CISG*

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### *1. Introduction:*

The United Nations Convention on Contracts for the International Sale of Goods has been ratified by 84 states<sup>1</sup> that account for a significant proportion of world trade. Despite the declaration in the Preamble about contributing to the achievement of a New International Economic Order (NIEO) and promoting the development of international trade on the basis of equality and mutual benefit, a disproportionate number of developing countries, including Iran, have not ratified it.

The Iranian Civil Code, the main source of the law of contract, was first prepared in 1928 and then completed in 1935-36.<sup>2</sup> This code has remained untouched for 80 years. During that time the volume, complexity and international character of commercial transactions have changed and the Iranian Civil Code is no longer suitable for modern international trade. The language of the Code and its terms are not suitable for international sales in the sense that there are elements of ambiguity and uncertainty in the provisions of the Iranian Civil Code. On top of that, the fact that it is not a well-established and well-known body of law might discourage Iran's trading partners from adhering to the Iranian Civil Code. This could put Iranian commercial traders in a disadvantageous position at the time of choice of applicable law during contract drafting. While each contractual party typically wishes to apply its national law, this may lead to choosing the law of Iran's trading partner (owing to the unpopularity of the Iranian Civil Code and/or unfamiliarity with it). In that case, if a dispute should arise, additional research at significant cost would be necessary to ascertain the actual content of the law chosen.<sup>3</sup> That is where the adoption of the CISG might be beneficial to Iran. The CISG, which is a more modern document developed in the light of the international character and complexity of current trade practices, responds better to international commerce. Therefore, it could be used by Iran to embark on updating its own domestic law of sale.

### *2. Fieldwork Summary in Iran*

In 2011/2012, the writer conducted a survey in Iran. The aim of the fieldwork was to conduct unstructured interviews with leading figures in business, law and Government in Iran with regard to the area of international trade. The goal was to determine: (i) whether they are familiar with the CISG; (ii) whether they support/oppose its introduction, with reasons why; and (iii) whether there are any other insights/observations on the potential difficulties of implementation.

The writer issued 60 documents and received only nine responses. The small number of responses means it is important to be cautious in interpreting results. However, three tentative conclusions can be drawn:

#### *1. Lack of Awareness*

Although it is arguable that the low level of response might reflect the technical nature of the subject, the lack of awareness of and familiarity with the CISG could be considered as one of the major factors potentially hindering accession. The implications of this lack of awareness are discussed below.

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\* This paper is an adaptation of her thesis submitted for the degree of Doctor of Philosophy in School of Law, University of Durham in September 2013 entitled 'The United Nations Convention on Contracts for the International Sale of Goods: Should Developing Nations Such As Iran Adopt the CISG?'.  
<sup>1</sup> As of 29 December 2015, UNCITRAL reported that 84 states have adopted the CISG.<sup>[1]</sup> CISG: Table of Contracting States' <<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>> accessed 7 March 2017.

<sup>2</sup> Hamid Bahrani-Ahmadi, 'A Historical Overview on the Development of Civil Code.' (Available in Persian.) <[http://www.isu.ac.ir/publication/research-quarterly/research-quarterly\\_24/Research-Quarterly\\_2402.htm](http://www.isu.ac.ir/publication/research-quarterly/research-quarterly_24/Research-Quarterly_2402.htm)> accessed 7 March 2017.

<sup>3</sup> 'CISG-Brazil interview with UNCITRAL Legal Officer Luca Castellani' (April 2010).



This is supported by interviews/questionnaires. One example is the ‘Mega Motor Company,’ whose managing director admitted his unfamiliarity with the CISG. It is worth mentioning that, with the exception of three that came from academia or the legal community, other endorsements for accession came from organizations whose level of familiarity with the CISG was either low or non-existent. In other words, despite unfamiliarity, they were not opposing accession to the CISG.

## II. *Direct Opposition*

With the exception of one vote against, the majority were in favour of adoption. However, the opposition is significant because, although it did not focus on trade issues, for instance on the fact that it is not yet evident whether the CISG would promote trade or reduce legal business (as in the UK), it focused instead on the secular nature of the CISG. A highly influential organization that was against ratification was the Trade Promotion Organisation of Iran, which is a subset of the Iran Chamber of Commerce, Industries and Mines. Their main objection was the incompatibility of the CISG with Islamic jurisprudence.

From this point of view it is not incorrect to oppose adoption of the CISG, on the grounds that the Convention specifies provisions with regard to interest that seem to be incompatible with Islamic and Iranian law.<sup>4</sup> For example, Article 84 of the CISG states that in the event that the seller is bound to refund the price, he must pay interest on it from the date the price was paid. Also, under CISG Article 78, it is clear that interest must be paid to the aggrieved party.

But this does not in fact introduce a radical change, since Iranian law recognizes late payment compensation (Articles 515(2) and 522 of the Iranian Civil Procedure Code 1379 (2000)), which is very similar to the notion of interest.<sup>5</sup> Moreover, when an action is brought outside Iran, Iranian authorities do request interest in their dealings and litigation arbitration proceedings with foreign corporations.<sup>6</sup>

Hence it could be very difficult politically to promote access to the CISG in Iran. Those who prefer secular law may feel that it is unwise to promote the Convention, as it may invite closer scrutiny of the Civil Code. It is only speculation, but it may explain the low rate of return of the questionnaires.

## III. *There Is Some Support for the CISG*

Several respondents stated their willingness to adhere to the CISG, but one went a step further and explained that Iran’s accession to the New York Convention (1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards) on 15 October 2001<sup>7</sup> implies that accession to the CISG is feasible. Those respondents who were very familiar with the CISG and in favour of accession put forward their arguments as follows:

1. Iran’s accession to the Convention would appear to have benefits for Iran at an international level. It is believed that it would promote Iran’s international trade and be beneficial for its economic growth and development. Iran’s trading partners would be able to predict the governing law of

<sup>4</sup> ‘LEGISLATIVE HISTORY 1980 Vienna Diplomatic Conference, Report of the First Committee.’ <<http://cisgw3.law.pace.edu/cisg/1stcommittee/summaries78,84.html>> accessed 7 March 2017. Egyptian Delegate proposed ‘it would be advisable to provide for reservations which would permit any country, particularly those where the concept of interest was incompatible with their religion, to apply the relevant clauses in a different manner.’ ‘LEGISLATIVE HISTORY 1980 Vienna Diplomatic Conference, Summary Records of Meetings of the First Committee, 34th meeting.’ <<http://cisgw3.law.pace.edu/cisg/firstcommittee/Meeting34.html>> accessed 7 March 2017.

<sup>5</sup> H Safai, M Adel, M Kazemi, and A Mirzanejad, *The Law of International Sale of Goods — A Comparative Study* (2nd edn, University of Tehran Press 2008) 446. (Available in Persian.)

<sup>6</sup> Sayed Hassan Amin, ‘Banking and Finance Based On Islamic Principles — Law and Practice in Modern Iran’ (1989) 9 *Islamic and Comparative Law Quarterly* 1.

<sup>7</sup> The New York Convention came into force on 13 January 2002.

the contract. This governing law, which is familiar to them and derived from international customs and trade usages, would enable them to enter into contracts with Iran with a higher degree of certainty, which would in turn lead to the building of stronger relations.

2. Accession to the Convention would not mean that our own national law would be neglected or abandoned. Since the Convention governs only international sales contracts between parties whose places of business are in two different countries, the Iranian Civil Code would still govern contracts of sales made nationally.
3. A comparative study of the CISG and the Iranian Civil Code does not suggest any radical departure from our Civil Code.

### 3. *Future Action*

The three points made above suggest the following areas of action:

#### I. *Awareness*

There is clearly a great need for further awareness. The outcome of this survey shows that there is a lack of familiarity with and awareness of the CISG within the business community in particular. The problems this brings include not only a lack of support for the CISG but also the likelihood that the transition to the CISG would be more difficult. Although the writer in her thesis submitted for the degree of Doctor of Philosophy in 2013/14<sup>8</sup> has discussed that the CISG is preferable in many ways to the Civil Code, and that there are not that many incompatibilities between the two legal systems, many of the benefits would not be obtained if the legal and business community lacked the knowledge to take advantage of the CISG. Moreover, there is a risk that their lack of knowledge might increase the cost of doing business rather than reduce it, as the CISG is intended to do.

The CISG allows contracting parties to opt out of its provisions and choose the application of a different body of law. The source of this autonomy is contained in Article 6 of the Convention, which permits signatories to 'opt out' of the Convention in its entirety or to derogate from or vary the effect of any of its principles. The reasoning behind this was that parties could always opt out of the provisions they wanted to avoid, and this is very useful, in particular for persuading sceptics to adopt the CISG. For example, in Iran those contracting parties that did not wish to apply the provisions on interest could declare that such provisions did not apply to their contract. However, anecdotal evidence suggests that, in taking advantage of Article 6, the legal profession fails to apply the CISG in cases where it could be very useful.<sup>9</sup> The statistics show that the rate of opt-out by lawyers in the US stands somewhere in the region of 55% to 71%. The figures for Germany, Switzerland, Austria and China are 45%, 41%, 55% and around 37% respectively.<sup>10</sup> But the question is, why do the lawyers opt out of the CISG? But, though the answer to this could be much extended, one of the main reasons is, again, lack of awareness and knowledge of the CISG. For instance, in the US, although it is a signatory state to the CISG, some 44% of lawyers are not at all familiar with the Convention.<sup>11</sup>

So how does one compensate for this lack of awareness? It seems that the most important resources through which one can raise awareness are law schools and the publication of scholarly writings, commentaries and court decisions in specialised and general law reviews. Time, cost and effort are indeed required at the start to become familiar with the CISG, but, given the position of Iran in the international community, such expenditure would seem to be of vital importance. It is then up to the legal and business communities to make their desire to ratify the CISG clear to the Government.

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<sup>8</sup> Mona Ahadi, 'The United Nations Convention on Contracts for the International Sale of Goods: Should Developing Nations Such As Iran Adopt the CISG?' (PhD thesis, University of Durham 2013). <[http://etheses.dur.ac.uk/16/1/Completed\\_Thesis.MA.pdf?DDD19+](http://etheses.dur.ac.uk/16/1/Completed_Thesis.MA.pdf?DDD19+)> accessed 7 March 2017.

<sup>9</sup> Bruno Zeller, 'The CISG — Getting off the Fence' (2000) 74(9) *The Law Institute Journal* 73.

<sup>10</sup> Lisa Spagnolo, 'A Glimpse through the Kaleidoscope: Choices of Law and the CISG (Kaleidoscope Part I)' (2009) *Vindobona Journal of International Commercial Law and Arbitration* 135, 140. <sup>[1]</sup><sub>SEP</sub>

<sup>11</sup> *Ibid.*

There is also an issue with the transition from the Civil Code to the CISG, but this should not create serious difficulties, as education would focus on ensuring that lawyers and professionals were comfortable with the CISG and could see its advantages. The writer acknowledges that there are some valid objections to the CISG that are related not to its usefulness but to its compatibility with Islamic principles. Therefore, this issue will need to be addressed separately.

## II. Concern Over Anti-Islamic Elements

The one vote against ratification registered during the writer's fieldwork came from the Trade Promotion Organisation of Iran. This Governmental organization appears to reflect the Government's view. However, the Government of Iran has never published any statement to express its direct and/or indirect opposition to ratification of the CISG.

The prohibition of interest by the *Qur'an*, which seems to be an impediment to accession to the CISG for Islamic countries, has to a certain extent been avoided by interpretation. Taking Egypt as an example, Article 226 of the Egyptian Civil Code awards interest.<sup>12</sup> Iraq also took a similar approach and applied award of interest to its law.<sup>13</sup> More importantly, as noted above, Articles 515(2) and 522 of the Iranian Civil Procedure Code 1379 (2000) introduce compensation for late payment, which is similar to the notion of interest.

Such interpretations perhaps explain why those Islamic countries that are party to the CISG<sup>14</sup> have not made reservations on Article 78, which deals with interest. One could however argue that the reason these countries can apply interest is that the Western legal structure has had a great impact on their legal systems, and the same approach may not apply to other Islamic countries. Although this is true, there is still Article 6 of the CISG, which formulates safety for Islamic countries, should they decide to avoid application of Article 78 of the CISG. Article 6 of the CISG, which provides that 'the parties may exclude the application of this Convention or ... derogate from or vary the effect of any of its provisions,' exemplifies the fundamental principle of freedom of contracts given to the parties.

## III. The Community That Would Probably Overcome (I) and (II)

It is the duty of this group — the community that is aware and in support of accession — to further facilitate accession to the CISG. It could be achieved by raising greater awareness and knowledge of the CISG through the use of the CISG database. 'The database is a collaborative effort between the Institute of International Commercial Law and the Pace Law Library.'<sup>15</sup> It accommodates over 2,900 cases and 1,600 full texts of commentaries. Besides, one of the main functions of the CISG Advisory Council, where a jurisdiction has not ratified it, is to encourage and help them to adopt and implement it.<sup>16</sup> More in-depth analysis and comparative study of the two legal systems (the CISG and Iranian law) would also enable Iran to overcome any apprehension over the anti-Islamic element of the CISG. An investigation into the compatibility of the CISG with Iranian law has shown that the two legal systems are by and large similar, and, where there are differences, sufficient principles can be found within Iranian law to bridge the gap.

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<sup>12</sup> Article 226 of Egyptian Civil Code reads:<sup>[1]</sup> 'When the object of an obligation is the payment of a sum of money of which the amount is known at the time when the claim is made, the debtor shall be bound, in case of delay in payment, to pay the claimant, as damages for the delay, interest ...'<sup>[2]</sup>

<sup>13</sup> Fatima Akaddaf, 'Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?' (2001) 13 Pace International Law Review 1.

<sup>14</sup> Bahrain, Egypt, Iraq, Syria and Mauritania are parties to the CISG.<sup>[3]</sup>

<sup>15</sup> See 'CISG Database.' <<http://cisgw3.law.pace.edu/>> accessed 7 March 2017.

<sup>16</sup> Interview with Dr Loukas Mistelis, former Secretary of the CISG-AC between 2001 and 2007, (June 2004) in Joshua D H Karton and Lorraine de Germiny, 'Has the CISG Advisory Council Come of Age?' (2009) 27 Berkeley Journal of International Law 448, 451.<sup>[4]</sup> <<http://ssrn.com/abstract=1509761>> accessed 7 March 2017.

## *In Favour of Appropriate Dynamic Interpretation for the CISG's Legal Uniformity*

*Zuoli Jiang, Shandong University Law School, People's Republic of China*

### *1. Introduction*

The United Nations Convention on Contracts for the International Sale of Goods 1980 (CISG) aims at removing the trade barriers for the promotion of international trade by virtue of setting standard for the unification of commercial law in the post-war era. However, in order to create legal uniformity it is insufficient to merely create and enact uniform instruments,<sup>1</sup> because uniform application of the agreed rules is by no means guaranteed, as in practice different countries almost inevitably come to put different interpretations upon the same enacted words.<sup>2</sup> Thus, an appropriate uniform interpretation of the CISG is essentially important to its legal uniformity.

Article 7 of the CISG indicates that courts of countries should not read and interpret the CISG through the lenses of domestic law, but rather in an “autonomous” manner. In other words, in interpreting the CISG one should not resort to the meaning generally attached to certain expressions within the ambit of a particular legal system.<sup>3</sup> However, due to the lack of a world international trade court with an exclusive authority in interpreting the CISG, domestic courts as the sole interpreter and the existence of numerous vague and ambiguous terms and gaps in the CISG as a result of complex international compromises negotiated by countries with extremely diverse economies and legal cultures and systems, the courts of different countries will inevitably interpret the CISG based upon their own economic, political, and legal orientations.<sup>4</sup> Some commentators believe that these diverging interpretations are greater obstacles to uniformity than once thought and suggest that pessimistically the CISG might not be a success.<sup>5</sup>

The purpose of this paper is not to give a brief account of the discussions about Article 7, but rather, this paper examines the current difficulties and problems of the uniform interpretation of the CISG by domestic courts, analyses the justification of the dynamic interpretation as the best approach of and solution to the problems for legal uniformity, and offer some suggestions to UNCITRAL's work to promote unification of international trade law.

### *2. The main difficulties of the uniform interpretation of the CISG for its legal uniformity*

The chief reason of the divergent interpretations by the courts of different countries is that there are numerous difficulties and the courts try to overcome them by reading and interpreting the CISG by virtue of their domestic laws and techniques.

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<sup>1</sup> L. M. Ryan, *The Convention on Contracts for the International Sale of Goods: Divergent Interpretations*, 4 *Tulane Journal of International and Comparative Law*, 99 (1995).

<sup>2</sup> Franco Ferrari, *The CISG's Uniform Interpretation by Courts — An Update*, 9 *Vindobona Journal of International Commercial Law & Arbitration*, 235 (2005).

<sup>3</sup> J. O. Honnold, *Uniform Law for International Sales under the United Nations Convention* (Deventer, 3<sup>rd</sup> ed., 1999) at 89.

<sup>4</sup> See, e.g., Arther Rosset, *Critical Reflections on the United Nations Convention on Contracts for the International Sales of Goods*, 45 *Ohio St. L. J.* 266 (1984); V. Susanne Cook, *Note, The Need for Uniform Interpretation of the 1980 United Nations Convention on Contracts for the International Sales of Goods*, 50 *U. Pitt. L. Rev.* 197 (1988); See Ryan, *supra* note 1, at 101; Shani Salama, *Pragmatic Responses to Interpretive Impediments: Article 7 of the CISG, an Inter-American Application*, 38 *Inter-American Law Review*(*U. Miami Inter-Am. L. Rev.*), 227 (2006); Frank Diedrich, *Maintaining Uniformity in International Uniform Law via Autonomous Interpretation: Software Contracts and the CISG*, 8 *Pace International Law Review* (*Pace Int'L. Rev.*), 304 (1996); Edita Ubartaite, *Application of the CISG in the United States*, 7 *European Journal of Law Reform* (*Eur. J.L. Reform*), 281 (2005).

<sup>5</sup> Philip Hackney, *Is the United Nations Convention on the International Sale of Goods Achieving Uniformity?*, 61 *La. L. Rev.* 476 (2001); Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 *Va. J. Int'l L.* 760 (1999); Steven Walt, *Novelty and the Risks of Uniform Sales Law*, 39 *Va. J. Int'l L.* 672 (1999); Aneta Spaic, *Approaching Uniformity in International Sales Law through Autonomous Interpretation*, 11 *Vindobona J. Int'l Com. & Arb.* 38 (2007).

### *2.1. There are so many vague and ambiguous terms and gaps in the CISG*

The CISG as the most successful attempt to unify international trade law is filled with countless vague and ambiguous standards and rules as result of compromises of so many countries.<sup>6</sup> First, there are so many legal concepts difficult to define. For example, “reasonable”, “place of business”, “good faith”, “substantial”, etc. Secondly, some rules are vague, for example, Article 78 provides that if one party fails to pay the price or any other sum, the other party is entitled to interest on it, but it fails to give specific explanations. What is more important, there are certain aspects involving international sales that the CISG does not even address. For example, Article 2 excludes from application those transactions involving consumer goods, as well as those transactions involving money or investment securities, and the same article also excludes from coverage issues relating to property ownership in the goods though these issues are essential in determining the substantial rights of the parties.<sup>7</sup>

### *2.2. The criteria of uniform interpretation under the CISG are vague*

It is common knowledge that in order to uniform interpretation the CISG must specify criteria of interpretation as guideline of judicial interpretations by different courts. However, the international character, uniform application and good faith as the criteria of interpretation of the CISG are also too vague and lack important provisions, for example, the CISG fails to define the concepts of international character, good faith and its scope of application and fails to spell out the role of general principles, etc. In addition, Article 7 fails to specify interpretation methodology.

These failures make Article 7 the most problematic one in the CISG and lead to endless arguments between scholars and judges which result in inevitable divergent interpretations, and will not be helpful to the uniform interpretation of the CISG, and even become barriers to the unification of international trade law.<sup>8</sup>

### *2.3. The CISG fails to expressly provide the sources for consideration*

Both jurisprudence and judicial practices demonstrate the importance of sources in the legal interpretation. Actually, the specific provisions of sources in the interpretation of international conventions are even more important than the national law because it is extremely difficult to unify the jurisprudence and judicial practices of different countries. However, the CISG does not provide specific guidance on the sources to be considered in interpretation. For example, foreign decisions interpreting the CISG are so important to national courts but the CISG fails to give any specific guidance.<sup>9</sup>

### *2.4. The role of Vienna Convention on the Law of Treaties is limited*

In light of the fact that Article 7(1) of the CISG does not prescribe the theoretical methods of interpretation to be utilized, guidance on this matter would have to be obtained elsewhere. As uniform interpretation of the CISG is of utmost importance for its uniform application, regard must be had to universally accepted framework of interpretational guidelines. These guidelines are to be found in the Vienna Convention on the Law of Treaties (the Vienna Convention).<sup>10</sup>

<sup>6</sup> Clayton P. Gillette & Robert E. Scott, *The Political Economy of International Sales Law*, 25 *Int'l Rev Of L. & Econ.* 474 (2005).

<sup>7</sup> James P. Quinn, *The Interpretation and Application of the United Nations Convention on Contracts for the International Sale of Goods*, 9 *Int'l T. Bus L. Rev.* 4 (2004); Rod Andreason, *MCC-Marble Ceramic: The Parol Evidence Rule and Other Law under the Convention on Contracts for the International Sale of Goods*, 1 *Byu L. Rev.* 352 (1999).

<sup>8</sup> Christopher Sheaffer, *The Failure of the United Nations Convention on Contracts for the International Sale of Goods and A Proposal for a New Uniform Global Code in International Sales Law*, 15 *Cardozo J. Int'l & Comp. L.* 472 (2007); James E. Bailey, *Facing the Truth: Seeing the Convention on Contracts for the International Sale of Goods as an Obstacle to a Uniform Law of International Sales*, 32 *Cornell. Int'l L. J.* 293 (1999).

<sup>9</sup> See Cook, *supra* note 4, at 211.

<sup>10</sup> Marlene Wethmar-Lemmer, *Regional Harmonization of International Sale Law via Accession to the CISG and the Importance of Uniform Interpretation of the CISG*, 47 *De Jure* 305 (2014).

There are long-time arguments between scholars on the application of the Vienna Convention to the interpretation of the CISG. Several scholars represented by Honnold hold that the CISG is an international convention only for sale of goods and the Vienna Convention applies to regulate only the relationships of its member countries, therefore, they contest the application of the Vienna Convention. The autonomous interpretation provided in the CISG excludes the application of both national laws and public international laws.<sup>11</sup> Other commentators support reference to the Vienna Convention to provide guidelines for the interpretation of the CISG because Article 1 of the Vienna Convention provides that it is applicable to treaties between states and that the CISG therefore falls under its scope of application. Also, the Vienna Convention is universally accepted as customary international law and should be applied to the interpretation of the CISG and there will be no conflicts in the process of interpretation.<sup>12</sup> There are also some scholars who neutrally advocate that both Article 7 of the CISG and the Vienna Convention are applicable but they must be divided into two parts: Articles 31-33 of the Vienna Convention should apply to interpret Articles 89-101 of the CISG, and Article 7 of the Convention should apply to interpret the other articles of the Convention. One argument in this regard is that Article 7 is the special law and Articles 31-33 of the Vienna Convention are common law, thus the former applies in priority, while the latter applies only Article 7.<sup>13</sup>

Clearly, the Vienna Convention can be guidelines for the interpretation of the CISG, but its role is rather limited.

### 3. *The recourse to the interpretation sources as the main practical problems in the interpretation of the CISG by courts of most countries*

The modern theories of interpretation and methods are mainly originated in the legal interpretation of ancient Roman law, and up to now, varied methods of interpretation already form such as literal interpretation, historical interpretation, purpose interpretation and dynamic (evolutional) interpretation. Broadly, these methods can be classified into static interpretation and dynamic interpretation. The historical development of legal interpretation demonstrate that several methods are usually comprehensively utilized in practical interpretations. The most important argument between scholars and judges in interpretation is the role of dynamic interpretation represented by the role and ranking of different sources of interpretation. The static interpretation emphasizes the text, preparatory materials, intent of drafters, legislative purpose, while the dynamic interpretation pays more attention to legal principles, foreign case law, academic writing, principles of public international law, national law, etc.

#### 3.1. *The general principles on which the CISG is based*

Article 7(2) provides that if questions are not expressly settled in the CISG, they shall be settled in conformity with the general principles on which the CISG is based. The ambiguous methodical interpretation of Article 7 results in the variant judicial interpretations.<sup>14</sup>

The static interpretation supporters insist that the CISG does not list specific general principles, that it is difficult, even impossible to find them, and are opposed to any dynamic interpretations. The dynamic interpretation supporters contend that general principles can be found through induction from two sources: the articles of the CISG and the process of legal development. In this way, the guidelines can be found for interpreting the CISG not to leave uncertainty which leads to national laws for interpretation by judges.<sup>15</sup>

<sup>11</sup> See Honnold, *supra* note 3, at 103.

<sup>12</sup> See Wethmar-Lemmer, *supra* note 10, at 305; Tom Allen, General Principles of International Law and the Autonomous Interpretation of the Convention on Contracts for the International Sale of Goods, 8 J. Islamic St. Prac. Int'l L. 94 (2012).

<sup>13</sup> LiuYing, Study of Interpreting Problems of the United Nations Convention on Contract for the International Sale of Goods, 1th ed., Law Press China, 11(2009). See Wethmar-Lemmer, *supra* note 10, at 305.

<sup>14</sup> See Sheaffer, *supra* note 8, at 462.

<sup>15</sup> John O. Honnold, Documentary History of the Uniform Law for International Sales: the Studies, Deliberations, and Decisions that Led to the 1980 United Nations Convention with Introductions and Explanations, 198 Kluwer Law and Taxation Publishers (1989), at 20.

Comparatively, more scholars and judges agree to identify general principles more flexibly. Some argue that an international convention is a living maturing body of law, founded on certain fundamental values but capable of adapting new interpretations for changed environments.<sup>16</sup> Therefore, a dynamic understanding of Article 7(2) is conducive to settle questions that the CISG failed to provide for definitely.<sup>17</sup> Only an active judicial interpretation of a convention can “keep the ship afloat,” because there is little hope “that [legislative] rescue will arrive.”<sup>18</sup>

From the perspective of dynamic interpretation, several general principles can be deduced: the principle of protecting the injured party’s expectation interest from Articles 45(2), 47(2) and 48(1), the principle of protecting restitution property from Article 81(2), and the principle of reliance interest from Articles 85, 86(1) and 88(3), etc. One national court induced the principle of burden of evidence by the buyer who claims that the goods delivered are not in conformity with the contract.<sup>19</sup>

Certainly, the identifying and extracting many of the general principles through deduction is not unlimited, and it should be kept in mind that the CISG’s overall objective is to promote international trade by removing legal barriers that arise from different social, economic, and legal systems of the world. Namely, the present purpose of finding general principles from the text of the CISG and from its legislative history is to help produce at least the narrow effect of preventing interpretations of the CISG based on domestic law.<sup>20</sup>

### 3.2. *Foreign case law*

Due to the failure of specific provisions of the CISG, the resort to foreign case law has been also highly controversial. Some contend the regard on the foreign case law, while others are in favour of the reference of foreign case law. Most scholars infer that the “international character” of the CISG requests the interpreters to break away from domestic legal concepts and interpreting techniques and consider international legal texts,<sup>21</sup> “the promotion of uniform application” requires taking into account relevant foreign case law. Uniformity can only be achieved if one also considers foreign case law. One further points out that the interpreter must consider decisions rendered by judicial bodies of foreign jurisdictions, because it is possible that the same or similar questions have already been examined by other States’ courts.<sup>22</sup>

Another feature of dynamic interpretation in this regard lies in the finding of general principles on which the CISG is based from foreign case law. For example, one German court stated that autonomy is one principle of the CISG,<sup>23</sup> and many courts indicated that “estoppel” is also the CISG’s principle.<sup>24</sup> It should be stressed that in the case where questions that cannot be settled according to the expressed rules

<sup>16</sup> Michael P. Van Alstine, *Dynamic Treaty Interpretation*, 146 U. Pa. L. Rev. 783 (1998).

<sup>17</sup> See Salama, *supra* note 4, at 242.

<sup>18</sup> See Alstine, *supra* note 16, at 777.

<sup>19</sup> See Case HG930138, (Italy v. Switz.), Handelsgericht Zürich (Sep. 9, 1993), available in UNILEX, A Comprehensive and “Intelligent” Data Base on the UN Convention on Contracts for the International Sale of Goods (CISG), Transnational Juris Publications, Inc. Irvington. N.Y. )

<sup>20</sup> Phanesh Koneru, *The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles*, 6 Minn. J. Global Trade, 117 (1997).

<sup>21</sup> See Wethmar-Lemmer, *supra* note 10, at 301.

<sup>22</sup> Elizabeth H. Paterson, *United Nations Convention on Contracts for the International Sale of Goods: Unification and the Tension Between Compromise and Domination*, 22 Stan. J. Int’L L. 263, 283(1986); Franco Ferrari, *CISG Case Law: A New Challenge for Interpreters?* 17 J. L. & Com. 254 (1998); C. B. Andersen, *Uniform International Sales Law and the Global Jurisconsultorium*, J. L. & Com. 159 (2005); Joseph Lookofsky, *Understanding the CISG: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods*, 3<sup>rd</sup> Edition, Kluwer Law International, 30 (2008).

<sup>23</sup> A. Kritzer, *Guide to Practical Application of the United Nations Convention on Contracts for the International Sale of Goods*, /Deventer, 1989, 114.

<sup>24</sup> Rechtbank Amsterdam, October 5, 1994, *Nederlands Internationaal Privaatrecht*, 1995, No. 231; Franco Ferrari, *Article 7*, in P. Schlechtriem (ed.), *Kommentar Zum UN-Kaufrecht-CISG*, Munich, 3<sup>rd</sup> ed., 2000, 134.

of the CISG and the general principles cannot be deduced in order to fill gaps, the courts must settle them by resort to foreign case law.<sup>25</sup>

### 3.3. Domestic laws

Article 7(2) provides that if questions concerning matters governed by the CISG are not expressly settled in it, they shall be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law. This indicates clearly that domestic law can be utilized to fill gaps in the CISG. However, there has been heated debate on whether regard shall be had on domestic law as interpretation source. Supporters believe interpreters are not only allowed to consider domestic law but also are obligated to do so.<sup>26</sup> Bonell further argues that the use of domestic law “represents under the ...uniform law a last resort to be used only if and to the extent a solution cannot be found either by analogical application of specific provisions or by the application of general principles underlying the uniform law as such.”<sup>27</sup> The last resort status of domestic sales law is meant to deter the threat of homeward trend. This is especially crucial in the case of the CISG due to the fact that its provisions were the product of intense debate and compromise.<sup>28</sup> One against the use of domestic law contends that the recourse to rules of private international law represents regression into doctrinal fragmentation and practical uncertainty. The relevant reference to such a method in Article 7(2) is unfortunate, as it does not assist the goal of uniformity. Recourse to the rules of private international law impedes and frustrates the unification movement and can reverse the progress achieved by the world-wide adoption of the CISG.<sup>29</sup>

With respect to the use of domestic law by national courts, Honnold helplessly calls it “homeward trend” and points out that this is an inevitable phenomenon.<sup>30</sup> One scholar has examined some cases by some German courts and holds that an interpretation that is informed by national approaches may enhance the long-term legitimacy of the CISG.<sup>31</sup>

### 3.4. Academic writings

The important role of academic writings in judicial interpretation is originated from the ancient Roman law and is an important part of dynamic interpretation. In the years of the third century B. C., the ancient Roman law was not sufficient to regulate the prosperous contacts between Rome, Greece, Egypt etc., courts had to resort to academic writings to fill gaps of old laws. In the years of the first century A. D., academic writings became the first source and authority in the legal interpretation by courts: the agreed interpretation by jurists is binding to judges.<sup>32</sup> The famous Law of Citations promulgated by the Roman Emperors required the courts of the Roman Empire to follow the opinions of five jurisconsults and determine which one of them was to be given priority in case they disagreed among themselves. It must be emphasized that the

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<sup>25</sup> Many courts in their judicial practices have found out general principles from foreign case law to settle questions not explicitly settled in the CISG. (See Franco Ferrari, Gap-Filling and Interpretation of the CISG: Overview of International Case Law, 2003 Int'l. Bus. L. J. 228, (2003).)

<sup>26</sup> M. J. Bonell, Article 7, in *Convezione di Vienna sui Contractti di Vendita Internazionale di Beni Mobili* 25 (Cesare Massimo Bianca ed., 1991); John Felemegas, *The United Nations Convention on Contract for the International Sale of Goods*, Kluwer Law International, 163 (2000-2001).

<sup>27</sup> M. J. Bonell, Introduction to the Convention, in *Commentary on the International Sales Law* 79 (Cesare M. Bianca & Michael. J. Bonell, eds. 1987); See Koneru, *supra* 20, at 105.

<sup>28</sup> Larry A. DiMatteo, The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence, 24 *Northwestern Journal of International Law & Business* (Nw. J. Int'l & Bus), 314 (2004).

<sup>29</sup> John Felemegas, *The United Nations Convention on Contract for the International Sale of Goods*, Kluwer Law International, 165 (2000-2001); See Koneru, *supra* 20, at 123.

<sup>30</sup> John O. Honnold, *Documentary History of the Uniform Law for International Sales: the Studies, Deliberations, and Decisions that Led to the 1980 United Nations Convention with Introductions and Explanations*, 198 Kluwer Law and Taxation Publishers (1989), at 26.

<sup>31</sup> See Karen Halverson Cross, Parol Evidence Under the CISG: The “Homeward Trend” Reconsidered, 68 *Ohio St. L. J.* 158 (2007).

<sup>32</sup> Chaobi Chen, *Fundamentals of Roman Law*, Law Press China, 2006, p. 19; Edgar Bodenheimer, Doctrine as a Source of the International Unification of Law, 34 *American Journal of Comparative Law*, 71, 72 (1986).



Roman glossators construed only the meaning of the legal texts in the early years, but later they began to make comments to adapt to the changed circumstances. The commentaries by jurists of the Justinian Code as the main body of the famous Digest is highly creative and binding, and also a good example of dynamic interpretation in Roman Law to adapt to new social changes.<sup>33</sup> Obviously, dynamic interpretation developed in line with and acted as important impetus to the Roman Law

Generally, the Roman Law exerts an influence both on the civil law and common law, but more on civil law and less on common law. As a result, courts in both common law and civil law nations do give consideration to scholarly writings, albeit in different degrees. Specifically, differences exist between the national courts involving the issue of what constitutes primary and secondary sources of legal authority.<sup>34</sup> While a US judge would likely refer to prior CISG case law in his efforts to render a uniform interpretation of the CISG, a French judge would likely refer to scholarly commentary in place of the judicial decisions themselves.<sup>35</sup>

One scholar concludes that among civil law jurisdictions, reliance on scholarly articles has long been utilized in interpretation of the law. Although courts of common law jurisdictions, by contrast, have been reluctant to confer the same weight to academic opinion when resolving disputes, there is evidence that common law courts are beginning to shift their approach, especially when faced with legal complexities involving international disputes.<sup>36</sup>

#### 4. *The justification of the dynamic interpretation in the CISG's uniform interpretation*

Conventional interpretation can be broadly classified into static interpretation and dynamic interpretation. The former is basically based on the original intent of the legislature and asks how the legislature originally intended the interpretive question to be answered, or would have intended the question to be answered had it thought about the issue when it passed the statute.<sup>37</sup> Comparatively, dynamic interpretation pays more attention to the dynamic nature of statutes, stating that statutes have different meanings to different people, at different times, and in different legal and societal contexts and that courts should interpret statutes in light of their current as well as historical context. That is, this view rejects the notion that “the meaning of a statute is set in stone on the date of its enactment.” Rather, it is argued, in the event of an evolution in the relevant public values, federal courts have the authority to develop new legal standards and even to adapt otherwise clear statutory text to accommodate a changed societal and legal environment.<sup>38</sup> Dynamic interpretation is most appropriate when the statute is old yet still the source of litigation, is generally phrased, and faces significantly changed societal problems or legal contexts.<sup>39</sup>

Dynamic interpretation as a new method of conventional interpretation is undoubtedly the product of exploration by scholars and judges to settle new problems, due to the fact the traditional methods of literary interpretation, purpose interpretation provided for by the Vienna Convention failed to meet the requirements of the current economic globalization. Although this new method of interpretation may still lead to criticism, relevant legal theories in favour of it are to mature and so many courts and tribunals have already resorted to it in their judicial interpretation. Therefore, it is now an independent method of conventional interpretation.<sup>40</sup>

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<sup>33</sup> See Chen, *supra* note 32, at 20.

<sup>34</sup> See Honnold, *supra* note 3, at 47.

<sup>35</sup> See Quinn, *supra* note 7, at 15.

<sup>36</sup> See Sheaffer, *supra* note 8, at 493.

<sup>37</sup> Richard Posner, Statutory Interpretation—in the Classroom and in the Courtroom, 50 U. Chi. L. Rev. 800, 817-22 (1983).

<sup>38</sup> William N. Eskridge, Jr. & Philip P. Frickey, Statutory Interpretation as Practical Reasoning, 42 Stan. L. Rev. 1483 (1990).

<sup>39</sup> *Id.* at 1555; Michael P. Van Alstine, Dynamic Treaty Interpretation, 146 U. Pa. L. Rev. 774 (1998).

<sup>40</sup> Shipo Jiang, the Dynamic Interpretation of International Conventions, 14 Legal Methodology, 314, (2013).

#### *4.1. The economic globalization is the utmost impetus to the dynamic interpretation*

Along with the end of the Cold War, more and more countries have started to get involved in economic development, resulting in the unprecedented economic globalization that has naturally hastened the legal globalization under which the different interests of different countries are allocated. Recent years have witnessed the emergence of a whole new generation of international conventions designed to unify the law governing international commercial transactions. As national economies continue toward global integration, so too is the law progressing toward unification on an international level. New and broader perspectives on interpretation are required to accommodate the dynamics of this process.<sup>41</sup>

#### *4.2. The dynamic nature of Article 7 of the CISG requires dynamic interpretation*

In accordance with Article 7, international character is free from the influence of national legal concepts and terminology and even from the domestic interpretive techniques themselves, to promote uniform application requires cooperation among the formally independent national courts, questions left unresolved in a convention's express provisions must be settled in conformity with the general principles on which it is based. Each of these three elements of Article 7 carries an animating spirit of the interpretative paradigm. These norms have operated to give the codes the flexibility necessary to adapt to circumstances unforeseen at the time of their adoption. Dynamic interpretation is also compelled by the needs of international uniformity. Without a means for adaptation, the inevitable social and technological changes in the relevant field of commerce will make any formal unification of legal standards fleeting.<sup>42</sup>

#### *4.3. Articles 31-33 of the Vienna Convention demonstrate obvious dynamism*

As is mentioned above, the Vienna Convention can be utilized partly to interpret the CISG, and its Articles 31-33 have obvious dynamism. Firstly, the words' ordinary meaning can change with time because the Vienna Convention fails to define the "ordinary meaning". Secondly, the words such as "good faith", "object and purpose" should be interpreted dynamically. Thirdly, all the phrases of "subsequent agreements", "subsequent practice" and "relevant rules of international law" permit to be interpreted in accordance with changed circumstances. Finally, the phrases of "preparatory works" and "circumstances of a treaty's conclusion" manifest dynamism.<sup>43</sup> Haopei Li concluded that general international convention should be interpreted according to their social purposes and developments and the relevant interpretation can exceed the original intents of drafters.<sup>44</sup>

#### *4.4. So many legal theories are in support of dynamic interpretation*

In ancient times, the Roman glossators began to observe the relationship between literary interpretation and the changed circumstances and resort to dynamic interpretation to fill legal gaps. Grothius argued that due attention has to be paid to the true meaning of the drafters in conventional interpretation, however, if such interpretation leads to absurd or illegal outcome, true meaning can be speculated.<sup>45</sup> The mechanical jurisprudence of the late nineteenth century posits that law consists of rules promulgated by the sovereign legislature and mechanically applied by judges. In 1908, Pound questioned the mechanical jurisprudence and argued that judges should not only resort to precedents, rather should concern the social development so as to promote rather than impede the social development.<sup>46</sup> Another advocates that interpretation is not static, but dynamic. Interpretation is not an archaeological discovery, but a dialectical creation. Interpretation is not mere exegesis to pinpoint historical meaning, but hermeneutics to apply that meaning

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<sup>41</sup> See Alstine, *supra* note 39, at 694.

<sup>42</sup> *Id* at 733.

<sup>43</sup> Sondre Torp Helmersen, *Evolutionary Treaty Interpretation: Legality, Semantics and Distinctions*, 6 EJLS, 131 (2013).

<sup>44</sup> Haopei Li, *Introduction to Law of Conventions*, Law Press China, 2003, p. 361.

<sup>45</sup> Dongli Huang, *Interpretation of international Convention needs certain flexibility*, 3 International Trade, 34, (2005).

<sup>46</sup> Roscoe Pound, *Mechanical Jurisprudence*, 8 Columbia Law Review 605, (1908).

to current problems and circumstances.<sup>47</sup> In 1920, Judge Cardozo confessed that the nature of the judicial process is “uncertainty”, rather than objective answers, and that “the process in its highest reaches is not discovery, but creation.”<sup>48</sup> Dworkin’s theory of statutory interpretation is part of his general theory of “law as integrity”, in which he argues that all law, including common law, statutes, and the Constitution, is a continuous process of interpretation. Dworkin has in an important way challenged scholars and judges to think about statutory interpretation as an ongoing process focusing on the present, and has linked his theory of statutory interpretation with a comprehensive theory of law.<sup>49</sup> Judge Posner also as a leading scholar of economics of law has suggested reasons for reading generally worded statutes dynamically, stating that when Congress has basically dropped a problem into the collective judicial lap, with imprecise and only general directions, then it makes sense for courts to develop that statute in accordance with contemporary, rather than purely historical policy.<sup>50</sup>

Clearly, dynamic interpretation is justified by current jurisprudence though may still lead to criticism.

##### 5. *Some suggestions to UNCITRAL’s practical work to encourage the reasonable dynamic interpretation*

There are at least three main reasons for the divergent interpretations by different national courts of the CISG. First, the CISG is too old to settle the questions arising from the unprecedented unification of international trade law pushed forward by the economic globalization. Second, the CISG is filled with numerous vagueness, ambiguities, and gaps from which national judges cannot find relevant rules to settle problems and have to resort to their own national laws and interpretative techniques. Third, historically and jurisprudentially, dynamic interpretation is the most usual and effective method of interpretation to fill gaps in old laws to settle new questions in changed environment. Accordingly, there are at least three approaches for UNCITRAL to encourage dynamic interpretation by national courts. First, substantive revision should be made to the CISG to improve its rules and fill gaps. Second, a guide to or a standard for the CISG must be enacted to make detailed rules of dynamic interpretation. Third, recommendations should be made to dynamic interpretation to national legislatures, courts and law practitioners.

Comparatively, the first approach can solve the problem more thoroughly but difficult to put into practice currently because the revision of international convention is a lot difficult than national laws. The third approach sounds reasonable but it may not be persuasive enough to settle substantive questions. The second approach is, by contrast, the most effective and practical way to improve substantively the CISG as an old law to settle new problems of the economic globalization.

It is true that UNCITRAL has established both the CLOUT system and the Digest as important strategic tools to assist in uniform interpretation, however, the lack of substantive progress can only be an indication that additional efforts are required.<sup>51</sup> Accordingly, I suggest that UNCITRAL enact the guide to the CISG that should contain the following points:

##### 5.1. *The guide should have an emphasis of the standards for the dynamic interpretation of the CISG*

It must be kept in mind that the dynamic interpretation concerns the misuse of judges’ judicial initiative if it is resorted to without any reasonable limitations. As a result, the guide should lay emphasis on the three interpretative standards provided for in Article 7: international character, uniform application and good faith. In other words, the dynamic interpretation of the CISG must be done under the guidelines of the three standards. Also the guide should provide for specific interpretative methods to refrain from unreasonable divergent interpretations.

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<sup>47</sup> William N. Eskridge Jr, Dynamic Statutory Interpretation, 135 U. Pa. L. Rev. 1482 (1987).

<sup>48</sup> *Id* 1507.

<sup>49</sup> *Id* 1550.

<sup>50</sup> *Id* 1517.

<sup>51</sup> Renaud Sorieul, Emma Hatcher, & Cyril Emery, Possible Future Work by UNCITRAL in the Field of Contract Law: Preliminary Thoughts from the Secretariat, 58 Vill. L. Rev. 503 (2013).

### 5.2. *The guide should specify relevant rules and fill the gaps of Article 7*

As is mentioned above, the numerous vagueness, ambiguities and gaps of Article 7 are the chief hidden danger of divergent interpretations and the guide should define specifically the words such as “regard”, “the need”, “good faith”, “general principles” and “by virtue of”, and add up to new rules such as the specific sources of law that judges must resort to, and the way to find out general principles.

### 5.3. *Due attention should be paid to academic writings and the CISG cases by different courts and tribunals*

In order to provide guidance as to the correct interpretation of the texts and identify and fill any gaps to contribute more to the uniform interpretation of the CISG, UNCITRAL should examine and analyse carefully the academic writings and the CISG cases of different courts and tribunals. In this way, the guide can achieve bigger powers of persuasion and application.

### 5.4. *The guide has to be more persuasive but not be necessarily binding*

In order to lead to less criticism arising from sovereignty and other possible issues, the guide should at best be persuasive, but not binding, on courts.<sup>52</sup>

This approach could inadvertently bring about criticism of scholars and judges, however, as the economic globalization is developing more and more rapidly, the CISG has been accepted by more and more states and parties who recognize the importance of uniform application of the CISG and the significant achievements of UNCITRAL. What is more, UNCITRAL has gathered so much experience by having enacted so many model laws, guides and established the Case Law on UNCITRAL Texts (CLOUT) and the UNCITRAL Digest of case law as great contribution to the unification of international trade law.<sup>53</sup> In this connection, this approach is of bright future and worth trying.

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<sup>52</sup> UNCITRAL has considered several proposals such as establishing a permanent editorial board and the Digest that should provide more detailed guidance as to the interpretation of the CISG. Neither of these proposals was adopted. (See Sorieul, *supra* note 51, at 504.

<sup>53</sup> Spiros V. Bazinas, Uniformity in the Interpretation and the Application of the CISG: The Role of CLOUT and the Digest, presented in “Celebrating Success: 25 Years United Nations Convention on Contracts for the International Sale of Goods” (Collation of Papers at UNCITRAL-SIAC Conference 22-23 September 2005, Singapore)(available at <http://www.cisg.law.pace.edu/cisg/biblio/bazinas.html>).

*Towards the implementation of International Civil and Commercial Law: A call for Qatar to join the United Nations Convention on Contracts for the International Sale of Goods (CISG)*  
**نحو إعمال قواعد القانون المدني والتجاري الدولي: دعوة لانضمام دولة قطر الى اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع 1980 ( اتفاقية فيينا)**

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❖ مقدمة الدراسة

1. لطالما كانت عقود التجارة الدولية تركز أساساً على الأموال المادية، ولكن مع نمو التجارة الدولية وتطورها بدأت المفاهيم تتغير، و الحياة تتبدل، والتجارة تتطور، والعولمة تلقي بظلالها على معاملاتها.<sup>1</sup> وفي هذا الخضم الهائل من تعدد المعاملات التجارية برزت الى السطح علاقات تعاقدية جديدة تتلاءم مع النمو الإقتصادي والتقني<sup>2</sup>، واصبحت تجارة السلع والبضائع في تزايد مضطرب، مع ترابط هذه البضائع وارتباطها بقيم معنوية مستمدة من تميز هذه البضائع عن غيرها من حيث الجودة والخصائص المميزة، فأضحت تجارة البضائع مرتبطة بحقوق الملكية الفكرية خاصة التجارية والصناعية منها كالعلامات التجارية لتلك البضائع وغيرها.
2. ولا شك أن البيع الدولي للبضائع كأحد أبرز اوجه التجارة الحديثة، يقوم على أساس الحاجة المتبادلة بين طرفيها، حاجة البائع الدولي لتصريف بضائعه وتحقيق الأرباح، تقابلها حاجة المشتري الدولي لإشباع حاجات مستهلكي البضائع وطالبيها.
3. وقد وضع المشرع الدولي اطار شاملا ومتكاملا يرفع عقود بيع البضائع التي تتصف بصفة الدولية، رؤية منه انه هذه العقود بحاجة الى وضع اطار قانوني موحد يراعى تطبيقه بين كافة الدول المنظمة او عند اختيار الأطراف له كنظام قانوني حاكم حتى لو انتمى اطرافه الى دول غير منضمة الى هذا الاطار القانوني. وقد تمثل هذا الاطار القانوني المدني الدولي باتفاقية البيع الدولي التي أصدرتها الأمم المتحدة بشأن بيع البضائع والتي ستكون محور دراستنا في هذا البحث ، محاولين مواءمة احد القوانين المدنية العربية مع هذه الاتفاقية فيما تضمنته من قواعد مخصصة لعقد البيع، ومتلمسين الوصول الى نتائج من شأنها الحد على تبني هذه الاتفاقية نظرا لما تحققه من نتائج إيجابية من شأنها حفز وجذب الاستثمار الأجنبي علاوة على توفير ضمانات لهذا الاستثمار مرتبطة بثبات تشريعي مؤداه تطبيق اتفاقية البيع الدولي على العلاقة التعاقدية التي يبرمها المستثمر الأجنبي ان تعلق استثماره ببيع بضائع اتصف بصفة الدولية.
4. من هنا فإن الدراسة سوف تنصب على التعريف باتفاقية البيع الدولي ومواءمة قواعد البيع في القانون المدني القطري لها مع شرح ومناقشة نطاق إعمال هذه الاتفاقية بشأن البيع الدولي للبضائع واثار ذلك على التزامات وحقوق طرفي عقد البيع الدولي سواء البائع او المشتري، وكذلك على مسؤوليتهما في حال

<sup>1</sup> انظر مؤلفنا: ضمانات الاستثمار في الدول العربية، الطبعة الثانية، دار الثقافة للنشر، عمان- الاردن، 2010، ص2.

<sup>2</sup> See: D.Gohnson, The new International Economic Order, Year Book Of World Affairs, Vol 37, 1983 P,217.

انعقادها، وانعكاس ذلك في القانون المدني القطري ومدى تطلب انضمام قطر الى هذه الاتفاقية، وذلك على النحو التالي:

المطلب الأول: مدخل الى القانون المدني الدولي والتعريف باتفاقية البيع الدولي كجزء منه  
المطلب الثاني: آثار تطبيق الاتفاقية ومقارنتها مع بعض قواعد عقد البيع في القانون المدني القطري

## المطلب الأول

### مدخل الى القانون المدني الدولي والتعريف باتفاقية البيع الدولي كجزء منه

نعرض في هذا الاطار للتعريف بالقانون المدني الدولي وذاتيته وتكامله مع القانون التجاري الدولي ، والتعريف باتفاقية فيينا للبيع الدولي باعتبارها جزءا مهما من القانون المدني الدولي.

### أولاً: القانون المدني الدولي : متميز بذاتيته متمايز بدوليته متكامل مع القانون التجاري الدولي

5. يوصف القانون المدني عموماً بأنه "دعامة" القانون الخاص<sup>3</sup>، والفرع الرئيسي فيه، ويعرف بأنه القانون الذي ينظم علاقات التعامل بين الافراد سواء كانت شخصية او مالية، فيما لم ينظمه أي قانون اخر من فروع القانون الخاص كالتجاري او العمل.. الخ.<sup>4</sup>

6. ويضم القانون المدني – كما هو معروف - نوعين من القواعد:

(أ) القواعد المنظمة للعلاقات الشخصية بين الافراد: وهي المنظمة للأحوال الشخصية التي تشمل المسائل المتعلقة بالفرد وعلاقته بأفراد عائلته كالأهلية والنسب والزواج والطلاق والميراث والوصية والوقف والهبّة والنفقة وغيرها من المسائل ذات الصلة.<sup>5</sup>

(ب) القواعد المنظمة للعلاقات المالية بين الافراد: وهي التي تنصرف الى الحقوق المالية ، سواء كانت هذه الحقوق من قبيل الحقوق الشخصية فتسمى حينها الالتزامات التي يعتبر العقد من ابرز مصادرها، او كانت من قبيل الحقوق العينية اصلية كحق الملكية او تبعية كحق الرهن.<sup>6</sup>

7. ولعل جل القوانين المدنية العربية تعرف هذه التقسيمات لقواعد القانون المدني وما تتضمنه من موضوعات سواء كانت هذه الموضوعات مدنية الطابع ضمن قواعد القانون المدني ذاته او ضمن قوانين متصلة.<sup>7</sup>

د.حسن كبيرة، المدخل الى القانون ، منشأة المعارف للنشر، الإسكندرية، 1969، ص372.

د.رمضان أبو السعود – د.محمد منصور، المدخل الى القانون، منشورات الحلبي الحقوقية، بيروت، 2003، ص 471.

د.محمد حسام لطفي، المدخل لدراسة القانون في ضوء اراء الفقه وأحكام القضاء – نظرية القانون، ط5، دون ناشر، القاهرة، 5، 2003، ص 65.

د.سمير تناعو، النظرية العامة للقانون، منشأة المعارف للنشر، الاسكندرية، 1985، ص578.

صدرت اغلبية القوانين المدنية العربية كالتالي:

- |            |   |
|------------|---|
| ■ الأردن   | : القانون المدني - قانون رقم ( 43 ) لسنة (1976) وتعديلاته                     |
| ■ الإمارات | : قانون المعاملات المدنية – القانون الاتحادي رقم 5 لسنة 1985 المعدل 1987      |
| ■ البحرين  | : القانون المدني الصادر بالمرسوم بقانون رقم (19) لسنة 2001                    |
| ■ تونس     | : مجلة الالتزامات والعقود لسنة 1906 وتعديلاتها                                |
| ■ الجزائر  | : الامر رقم 58-75 المؤرخ 26 سبتمبر 1975 المتضمن القانون المدني المعدل والمتمم |
| ■ السودان  | : قانون المعاملات المدنية لسنة 1984   |
| ■ سوريا    | : مرسوم تشريعي رقم 84/ للعام 1949 وتعديلاته – القانون المدني                  |

8. وإذا ما اتصفت القواعد المنظمة للعلاقات الشخصية او المالية للأفراد بصفة الدولية دون التجارية او غيرها من الصفات التي ترتبط بطبيعة المعاملة، فإنه يحق لنا ولا ريب ان نطلق على هذه القواعد تسمية "القانون المدني الدولي"، ولنا في الفقه المدني الذي سقناه خير دليل وهو الذي يقسم قواعد القانون المدني الى قواعد منظمة للأحوال العينية وقواعد أخرى مخصصة للأحوال الشخصية.

9. ولعل ما يعزز توجهنا في إطلاق تسمية القانون المدني الدولي ان صفة الدولية ان اتصلت بمعاملة تجارية اصبح القانون المنظم لتلك المعاملة هو القانون التجاري الدولي ، وإذا ما اتصلت بمعاملة إجرائية بصفة دولية اصبح القانون المنظم لها هو قانون الإجراءات المدنية الدولية، وكذا الحال بالنسبة للتحكيم كوسيلة لتسوية المنازعات فإذا تعلق بنزاع تجاري اصبح تحكيميا تجاريا، وإذا ما اتسم بصفة الدولية اصبح تحكيميا تجاريا دوليا، اما ان اتقصر على صفة المحلية فإنه يكون تحكيميا محليا، وكذلك الحال بالنسبة للجرائم الدولية التي يطبق عليها ما يعرف بالقانون الجنائي الدولي، افلا يحق لأبي القوانين واصلها "القانون المدني" ان يحتفظ بذاتيته مع الاخذ بعين الاعتبار صفة الدولية ان ارتبطت بإحدى معاملاته ، كي نطلق على ما ينظمها تسمية القانون المدني الدولي؟!!

10. ولنا في تسميتنا هذه "القانون المدني الدولي " دليل آخر مستقى من المعايير الدولية ذاتها؛

■ فالمعايير الدولية التي تضعها لجنة الأمم المتحدة للقانون التجاري الدولي الاونسترال UNCITRAL تعالج العديد من الموضوعات والمبادئ القانونية التي تعد من صلب القانون المدني وان اضيفت عليها صفة الدولية، ومنها القواعد الحاكمة لعقد البيع، والاعسار، والقواعد التي ترعى مسألة التقادم في عقد البيع، ، وكذلك المبادئ التي ترعى التفاوض وتنفيذ العقود بحسن نية، وفكرة التعويض عند الاخلال بالعقود، إضافة الى مستجدات موضوع التأمينات او منح الائتمان واعتبار حقوق الملكية الفكرية ومنها حقوق المؤلف محلا لاحد اهم التأمينات وهو الرهن وهو ما اصطلح على تسميته دوليا "المعاملات المضمونة"<sup>8</sup>.

■ كما ان المعايير الدولية التي وضعها مؤتمر لاهاي للقانون الدولي الخاص والذي يسعى لتوحيد الحلول القانونية ركز على كثير من الموضوعات والمبادئ القانونية التي تعد من صميم القانون المدني خاصة فيما يتعلق بالقواعد الحاكمة للعلاقات الشخصية كالنفقة وحقوق الاسرة، وكذا القواعد الحاكمة للعلاقات المالية كعقد البيع والوكالة والاثبات في المواد المدنية والتجارية وغيرها من المسائل.<sup>9</sup>

- العراق : القانون المدني العراقي رقم (40) لسنة 1951 وتعديلاته
- عُمان : مرسوم سلطاني رقم 29 / 2013 بإصدار قانون المعاملات المدنية
- قطر : قانون رقم (22) لسنة 2004 بإصدار القانون المدني 22 / 2004
- الكويت : مرسوم بالقانون رقم 67 لسنة 1980 بإصدار القانون المدني ، وتعديلاته
- لبنان : قانون الموجبات والعقود 1932
- ليبيا : القانون المدني الصادر في 28 من نوفمبر 1953م. المعدل بقانون رقم ( 6 ) لسنة 2016 م
- مصر : القانون رقم 131 لسنة 1948 بإصدار القانون المدني وتعديلاته
- المغرب : قانون الالتزامات والعقود لسنة 1913 وتعديلاته 2015
- موريتانيا : قانون الالتزامات والعقود رقم 126 لسنة 1989
- اليمن : قرار جمهوري بالقانون رقم 14 لسنة 2002 بشأن القانون المدني

<sup>8</sup> انظر الموقع الالكتروني للاونسترال [http://www.uncitral.org/uncitral/ar/other\\_organizations\\_texts.html](http://www.uncitral.org/uncitral/ar/other_organizations_texts.html) تاريخ اخر زيارة 7 يناير 2017.

<sup>9</sup> وضع مؤتمر لاهاي للقانون الدولي الخاص 40 اتفاقية انضم الى بعضها بعض الدول العربية وادمجتها في نظامها القانوني، وهذه الاتفاقيات هي:

15 - 7-1955 ( والدول العربية المنضمة هي مصر 24-4-1961 1. النظام الأساسي لمؤتمر لاهاي للقانون الدولي الخاص. المغرب 6-9-1993 الاردن 13-6-2001 تونس 4-11-2014 السعودية 19-10-2016 )

- ( والدول العربية المنضمة هي: المغرب 14-9-2. اتفاقية 1 مارس 1954 الخاصة بالإجراءات المدنية. 12-4-1957  
1972 لبنان 7-1-1975 (ليست عضوا في مؤتمر لاهاي) مصر 16-11-1981 )
3. اتفاقية 15 يونيو 1955 الخاصة بالقانون الواجب تطبيقه على البيع الدولي للبضائع. 1-9-1964 ولم تنضم إليها أي دولة عربية
4. اتفاقية 15 أبريل 1958 الخاصة بالقانون المنظم لنقل الحقوق القانونية في البيع الدولي للبضائع. لم تدخل حيز النفاذ
5. اتفاقية 15 أبريل 1958 الخاصة باختصاص المحكمة المختارة في حالة البيع الدولي للبضائع. لم تدخل حيز النفاذ
6. اتفاقية 15 يونيو 1955 المتعلقة بحل النزاع بين قانون الجنسية وقانون مكان الموطن. لم تدخل حيز النفاذ
7. اتفاقية 1 يونيو 1956 بخصوص الاعتراف بالشخصية القانونية للشركات والجمعيات والمؤسسات الأجنبية. لم تدخل حيز النفاذ
8. اتفاقية 24 أكتوبر 1956 الخاصة بالقانون الواجب تطبيقه على الالتزامات المتعلقة بنفقة الأطفال. 1-1-1962 لم تنضم إليها أي دولة عربية.
- 1-1-1962 9. اتفاقية 15 أبريل 1958 بخصوص الاعتراف بالقرارات ذات الصلة بالالتزامات المتعلقة بنفقة الأطفال وإنفاذها. لم تنضم إليها أي دولة عربية
- 2-4-1969 لم تنضم 10. اتفاقية 5 أكتوبر 1961 بخصوص الاختصاص والقانون الواجب تطبيقه فيما يتعلق بحماية القصر. إليها أي دولة عربية
11. اتفاقية 5 أكتوبر 1961 الخاصة بتنزع القوانين بخصوص شكل الترتيبات المتعلقة بالوصايا. 5-1-1964 لم تنضم إليها أي دولة عربية
- 1-24-1965 وقد انضمت إليها 12. اتفاقية 5 أكتوبر 1961 القاضية بإلغاء شرط التصديق بالنسبة للوثائق العامة الأجنبية. سلطنة عمان 30-1-2012 (انضمت على الرغم من أنها ليست عضوا في مؤتمر لاهاي) وكذلك المغرب 31-8-2016 لم
13. اتفاقية 15 نوفمبر 1965 الخاصة بالاختصاص والقانون الواجب تطبيقه والاعتراف بالقرارات المتعلقة بالتبني. تدخل حيز النفاذ
14. اتفاقية 15 نوفمبر 1965 الخاصة بالخدمات في الخارج المتعلقة بالوثائق القضائية وغير القضائية ذات الصلة بالمسائل المدنية أو التجارية. 10-2-1969 وقد انضمت إليها مصر 10-2-1969 وكذلك الكويت 1-12-2002 (ليست عضوا في مؤتمر لاهاي) والمغرب 1-11-2011
- لم تدخل حيز النفاذ. 15. اتفاقية 25 نوفمبر 1965 الخاصة باختصاص المحكمة.
- 8-20-1979 16. اتفاقية 1 فبراير 1971 الخاصة بالاعتراف بالأحكام الأجنبية في المسائل المدنية والتجارية وإنفاذها. وانضمت إليها الكويت 1-12-2002 (ليست عضوا في مؤتمر لاهاي).
17. بروتوكول 1 فبراير 1971 التكميلي للاتفاقية الخاصة بالاعتراف بالأحكام الأجنبية في المسائل المدنية والتجارية وإنفاذها. 20-8-1979 وانضمت إليها الكويت 1-12-2002 (ليست عضوا في مؤتمر لاهاي)
- وقد انضمت إليها مصر 20-6-18. اتفاقية 1 يونيو 1970 الخاصة بالاعتراف بالطلاق والانفصال القانوني. 24-8-1975 1980
19. اتفاقية 4 مايو 1971 الخاصة بالقانون الواجب تطبيقه على الحوادث المرورية. 3-6-1975 وقد انضمت إليها المغرب 25-2010-6
20. اتفاقية 18 مارس 1970 الخاصة بالحصول في الخارج على الأدلة المتعلقة بالمسائل المدنية أو التجارية. 7-10-1972 وقد انضمت إليها المغرب 23-5-2011 و الكويت 7-7-2002 (ليست عضوا في مؤتمر لاهاي).
21. اتفاقية 2 أكتوبر 1973 المتعلقة بالإدارة الدولية لممتلكات الأشخاص المتوفيين. 1-7-1993 ولم تنضم إليها أي دولة عربية.
22. اتفاقية 2 أكتوبر 1973 الخاصة بالقانون الواجب تطبيقه على المسؤولية القانونية عن المنتجات. 1-10-1977 ولم تنضم إليها أي دولة عربية.
23. اتفاقية 2 أكتوبر 1973 الخاصة بالاعتراف بالقرارات المتعلقة بالالتزامات بالنفقة وإنفاذها. 1-8-1976 ولم تنضم إليها أي دولة عربية
24. اتفاقية 2 أكتوبر 1973 الخاصة بالقانون الواجب تطبيقه على الالتزامات بالنفقة. 1-10-1977 ولم تنضم إليها أي دولة عربية.
- 1-9-1992 ولم تنضم إليها أي 25. اتفاقية 14 مارس 1978 الخاصة بالقانون الواجب تطبيقه على النظام المالي للزوجين. دولة عربية.
26. اتفاقية 14 مارس 1978 الخاصة بالإشهار والاعتراف بشرعية الزواج. 1-5-1991 وقامت مصر بالتوقيع عليها بتاريخ 14-1978-3
27. اتفاقية 14 مارس 1978 الخاصة بالقانون الواجب تطبيقه على الوكالة. 1-5-1992 ولم تنضم إليها أي دولة عربية.
- 1-12-1983 وانضمت إليها المغرب 1-28. اتفاقية 25 أكتوبر 1980 الخاصة بالجوانب المدنية للاختطاف الدولي للطفل. 6-2010-6 والعراق 1-6-2014 (ليست عضوا في مؤتمر لاهاي)
29. اتفاقية 25 أكتوبر 1980 الخاصة بالوصول الدولي للعدالة. 1-5-1988 وقامت المغرب بالتوقيع فقط في 16-9-1981
30. اتفاقية 1 يوليو 1985 الخاصة بالقانون الواجب تطبيقه على "الترست" وعلى الاعتراف بها. 1-1-1992 ولم تنضم إليها أي دولة عربية.
31. اتفاقية 22 ديسمبر 1986 الخاصة بالقانون الواجب تطبيقه على عقود البيع الدولي للبضائع. لم تدخل حيز النفاذ.
32. اتفاقية 1 أغسطس 1989 الخاصة بالقانون الواجب تطبيقه على إرث ممتلكات الأشخاص المتوفيين.
33. اتفاقية 29 مايو 1993 الخاصة بحماية الأطفال والتعاون فيما يتعلق بالتبني عبر الدول. 1-5-1995 ولم تنضم إليها أي دولة عربية.
34. اتفاقية 19 أكتوبر 1996 الخاصة بالاختصاص، والقانون الواجب تطبيقه، والاعتراف، والإنفاذ والتعاون فيما يتعلق بالمسؤولية



■ يضاف الى ذلك ان المعايير الدولية التي اتى بها المعهد الدولي لتوحيد القانون الخاص (اليونيدروا) والتي تهدف الى توحيد القانون واعداد قواعد موحدة للقانون الخاص، تركز على موضوعات مدنية الطابع أساسها القانون المدني، كحقوق الامتياز على الأموال المنقولة، والمصالح الضمانية، وعقود الليزينغ، وعقود الفاكورنغ، وحقوق الدائنين، وغيرها من المسائل المدنية الخالصة المتصلة.<sup>10</sup>

11. كل ما سبق يؤكد ان هنالك قانونا مدنيا دوليا يقف جنبا الى جنب مع قوانين خاصة دولية أخرى كالقانون التجاري الدولي بموضوعاته المتعلقة باعسار الشركات والتحكيم التجاري الدولي وخلافه، الامر الذي يعد تكاملا بين هذه القوانين ، مع مراعاة خصوصية موضوعاتها الفرعية، وضمن اطار هذا التكامل بين القانون المدني الدولي والقانون التجاري الدولي ، فقد شهد العالم فى القرن الماضي تشكلاً لنظام عالمي جديد يقوم على اساس أن من يمتلك مفاتيح الإقتصاد، فانه يمتلك أسباب القوة، ذلك أن الإقتصاد يلعب دورا أساسياً في حلّ أو خلق المشكلات التي تعاني منها الدول نامية كانت أو متقدمة. ومع تزايد أعمال التجارة الدولية ودورها في تعزيز اقتصاديات الدول، برزت حاجة ملحة إلى أن تكون هنالك ثمة نظم قانونية تحكم تكوّن العلاقات التجارية، وتفض النزاعات الناشئة عنها فيما لو تعثرت مثل هذه العلاقات، ضمن اطار قانوني محكم حاولت المنظمات الدولية المعنية كاليونسترال ان تجعله نظاما موحدا لتوحيد الحلول القانونية.

### ثانيا: اتفاقية البيع الدولي كجزء من القانون المدني الدولي

12. تأتي اتفاقية فيينا للبيع الدولي وهي اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع التي اعتمدت في 11 نيسان/أبريل 1980،<sup>11</sup> بهدف توفير نظام موحد بشأن إبرام عقود البيع الدولي للبضائع، باعتبار عقد البيع من اهم ركائز التجارة الدولية في جميع الدول. كما تحاول هذه الاتفاقية تحقيق التوازن بين مصالح المشتري والبائع.

الأبوية وإجراءات حماية الأطفال. 1 - 1-2002 وانضمت المغرب 1-12-2002

35. اتفاقية 13 يناير 2000 الخاصة بالحماية الدولية للبالغين. 1-1-2009 ولم تنضم اليها أي دولة عربية.  
36. اتفاقية 5 يوليو 2006 الخاصة بالقانون الواجب تطبيقه على بعض الحقوق المتعلقة بالأوراق المالية المحتفظ بها لدى وسيط. لم تدخل حيز النفاذ

1-10-2015 ولم 37. اتفاقية 30 يونيو 2005 الخاصة باتفاقات اختيار المحكمة. ( حلت محل اتفاقية 25 نوفمبر 1965 ) تنضم اليها أي دولة عربية.

1-10-2013 ولم 38. اتفاقية 23 نوفمبر 2007 بشأن الوفاء الدولي بالنفقة الخاصة بالأطفال وأعضاء آخرين في الأسرة. تنضم اليها أي دولة عربية.

39. بروتوكول 23 نوفمبر 2007 بشأن القانون الواجب التطبيق على الالتزام بالنفقة. 1-8-2013 ولم تنضم اليها أي دولة عربية.  
40. مبادئ اختيار القانون المنطبق على العقود التجارية الدولية 19-3-2015.

انظر في ذلك أ.د. حفيدة الحداد، د. عبدالله عبد الكريم عبدالله، د. فاتن حوى، بيان بموقف الدول العربية والاسلامية من مؤتمر لاهاي، وثيقة مقدمة الى المؤتمر الاقليمي حول "توحيد القانون: مؤتمر لاهاي - اليونيدروا - اليونسترال" والذي نظّمته كلية الحقوق والعلوم السياسية بجامعة بيروت العربية بالتعاون مع جامعة جونز هوبكنز بالولايات المتحدة الامريكية و مؤتمر لاهاي، معهد توحيد القانون الخاص، ولجنة الأمم المتحدة للقانون التجاري الدولي في مقر جامعة بيروت العربية بتاريخ 10-11 أيلول/سبتمبر 2012 . كما يراجع بشأن هذه الاتفاقيات والدول المنضمة اليها المعلومات محدثة على الموقع الالكتروني لمؤتمر لاهاي تاريخ اخر زيارة 8 يناير 2017. <https://www.hcch.net/en/instruments/conventions>

<sup>10</sup> انظر لائحة بالاتفاقيات التي أصدرتها اليونيدروا ونصوصها على الموقع الالكتروني <http://www.unidroit.org/142-instruments/security-interests/cape-town-convention-mobile-equipment-2001/depositary/declarations-by-contracting-state/487-declaration-lodged-by-the-kingdom-of-saudi-arabia-under-the-cape-town-convention-at-the-time-of-the-deposit-of-its-instrument-of-ratification>. تاريخ اخر زيارة 8 يناير 2017.

<sup>11</sup> انظر نص الاتفاقية على الموقع الالكتروني الخاص بلجنة الامم المتحدة للقانون التجاري الدولي (اليونسترال) <http://www.uncitral.org/pdf/arabic/texts/sales/cisg/V1056999-CISG-a.pdf>

ويبلغ عدد الدول الاطراف في هذه الاتفاقية 85 دولة،<sup>12</sup> من بينها ( 6 ) دول عربية هي البحرين والتي بدء نفاذ الاتفاقية بشأنها بتاريخ 1-10-2014 ، سوريا والتي بدء نفاذ الاتفاقية بشأنها بتاريخ 1-1-1988، و العراق بتاريخ 1-4-1991 ، ولبنان بتاريخ 1-12-2009 ، ومصر بتاريخ 1-1-1988، وموريتانيا بتاريخ 1-9-2000.

13. ولعل الأبرز في هذه الاتفاقية هو توفير حلول موحدة بشأن النزاعات المرتبطة بهذه العقود،<sup>13</sup> بعيداً عن اللجوء إلى قواعد القانون الدولي الخاص لتحديد القانون الواجب التطبيق على العقد، فهي تأخذ بالاعتبار تنمية وتطوير حركة التجارة الدولية على أساس من المساواة والمنفعة المتبادلة علاوة على ما تنص عليه مختلف النظم القانونية.<sup>14</sup>

14. بيد أن نطاق إعمال هذه الاتفاقية على عقد البيع الدولي للبضائع يثير جملة من المسائل المرتبطة بحالات تطبيق أو عدم تطبيق هذه الاتفاقية، خاصة في ظل ما أشارت إليه المادة 6 من الاتفاقية والتي تنص على أن "يجوز للطرفين استبعاد تطبيق هذه الاتفاقية، كما يجوز لهما، فيما عدا الأحكام المنصوص عليها في المادة 12<sup>15</sup>، مخالفة نص من نصوصها أو تعديل آثاره".

15. من جهة أخرى ، إذا ما ركزنا دائرة الضوء على القانون المدني القطري،<sup>16</sup> نجد أن قواعده تنظم فقط العلاقات المالية أو بتعبير أدق الحقوق المالية التي تعبر عن الأحوال العينية – دون الشخصية – الخاصة بالعلاقات التي تنشأ بين الأشخاص ذات الطابع المالي ، وترتب آثاراً في الذمة المالية تتمثل إما في ترتيب الالتزامات على الأشخاص أو ترتيب حقوق لهم.<sup>17</sup> بينما أوكل القانون المدني القطري مهمة تنظيم العلاقات الشخصية – أو تنظيم الأحوال الشخصية – لقانون الأسرة القطري المستمد من أحكام الشريعة الإسلامية.<sup>18</sup>

16. وقد صدر القانون المدني القطري المعمول به حالياً في 2004 ويتألف من 1188 مادة ، وقد أتى ضمن باب تمهيدي وقسمين، فالباب التمهيدي عرض فيه في الفصل الأول لتطبيق القانون وسريانه من حيث الزمان والمكان من المواد 1 إلى 38، والفصل الثاني تناول فيه المشرع الأشخاص في المواد من 55 إلى 61، أما الفصل الثالث فخصصه المشرع للأشياء والأموال في المواد من 56 إلى 61، بينما خصص الفصل الرابع لاستعمال الحق ضمن المواد 62 و 63. وخصص المشرع القطري القسم الأول من القانون المدني لتناول الحقوق الشخصية- أو الالتزامات في المواد من 64 إلى -836، حيث عرض في الكتاب الأول منه لموضوع الالتزامات بوجه عام ، وخصص الكتاب الثاني للعقود المسماة . أما القسم الثاني فقد تناول فيه

<sup>12</sup> عدد الدول الاطراف لغاية تاريخ 7 يناير 2017

[http://www.uncitral.org/uncitral/ar/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/ar/uncitral_texts/sale_goods/1980CISG_status.html)

<sup>13</sup> انظر في فكرة التوحيد في تطبيق الاتفاقية: د. حسام الدين عبد الغنى الصغير، تفسير اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع، دار النهضة العربية، القاهرة، 2001، البند 81، الكتاب متاح الكترونياً على الرابط الإلكتروني

<http://cisgw3.law.pace.edu/cisgarabic/middleeast/interpretation.htm>

<sup>14</sup> انظر ديباجة اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع 1980 ( اتفاقية فيينا).

<sup>15</sup> شكل باتخاذ أي تسميح التي الاتفاقية هذه من الثاني الجزء أو 29 والمادة 11 المادة أحكام تنص المادة 12 من الاتفاقية على ما يلي " جميع تُطبق لا الطرفين أحد قصد عن الإعلان أو أو القبول الإيجاب لوقوع أو رضائياً فسخه أو تعديله أو البيع عقد انعقاد لأجل الكتابة غير هذه من 96 المادة بموجب تحفظها أعلنت التي الاتفاقية هذه إلى المنظمة المتعاقدة الدول في إحدى الطرفين أحد عمل مكان يكون عندما آثارها" تعديل أو المادة هذه مخالفة للطرفين يجوز ولا .الاتفاقية

القانون المدني القطري رقم (22) لسنة 2004.

د. جابر محبوب علي، النظرية العامة للالتزام – ج 1 مصادر الالتزام في القانون القطري، منشورات كلية القانون بجامعة قطر، الدوحة، 2016، ص3.

قانون الأسرة القطري رقم 22 لسنة 2006.

المشرع القطري موضوع الحقوق العينية في المواد من 837 الى 1186، حيث خصص الكتاب الأول للحقوق العينية الأصلية والكتاب الثاني للحقوق العينية التبعية "التأمينات العينية". علاوة على موضوعات ذات صبغة مدنية تناولتها قوانين خاصة بها كقانون الاسرة وقانون حق المؤلف والحقوق المجاورة وغيرها.

17. وقد خص المشرع القطري عقد البيع بالمواد من 419 الى 487 من القانون المدني القطري، وهو العقد الذي نحاول اجراء مواءمة الاحكام المنظمة له مع ما جاء في الاتفاقية المشار اليها باعتبارها جزءا من القانون المدني الدولي حسب ما اوردها.

### ثالثاً: البيوع الخاضعة لنطاق تطبيق الاتفاقية

18. تطبق الاتفاقية بشكل اساس على البيوع دولية الطابع،<sup>19</sup> والتي تتعلق بالبضائع وهي انت كاطار قانوني دولي موحد للحلول التشريعية الخاصة بعقود البيع الدولي للبضائع التي تنطبق عليها، في محاولة للتغلب من اللجوء إلى قواعد القانون الدولي الخاص بشأن هذه العقود.<sup>20</sup>

19. وتتكون الاتفاقية من اربعة اجزاء خصص الاول لنطاق تطبيقها وبعض الاحكام العامة، حيث تشير الاتفاقية في المواد من 1 لغاية 6 ضمناً الى عقود بيع البضائع الخاضعة لنطاق تطبيق الاتفاقية، وتلك التي تستثنى من تطبيق الاتفاقية عليها، علاوة على ما تتعرض له الاتفاقية من موضوعات تقتصر على تكوين العقد واثاره الخاصة بحقوق وواجبات طرفي هذا العقد.<sup>21</sup> وسنعرض في هذا الاطار للبيوع الخاضعة لنطاق تطبيق الاتفاقية، ثم نخصص حيزاً للمسائل الموضوعية الخاضعة لنطاق تطبيق الاتفاقية.

20. تشترط الاتفاقية لتطبيق احكامها ان يكون هنالك ثمة بيع يتصف بصفة الدولية، اي ان يتم بين طرفين يوجد مقر عملهما في دولتين متعاقبتين مختلفتين،<sup>22</sup> اي الاتفاقية نافذة بحقهما،<sup>23</sup> أو عندما تقضي قواعد القانون

<sup>19</sup> Matthew A. Peluso, Convention on Contracts for the International Sale of Goods — An Example of Successful International Commercial Diplomacy, The Magazine for International Business and Diplomacy, No. 3 March 2011, Published on <http://www.ibde.org/component/content/article/98-convention-on-contracts-for-the-international-sale-of-goods-an-example-of-successful-international-commercial-diplomacy.html>.

<sup>20</sup> انظر معلومات تفصيلية حول الاتفاقية على الموقع الالكتروني للجنة الامم المتحدة للقانون التجاري الدولي "اليونسترال" [http://www.uncitral.org/uncitral/ar/uncitral\\_texts/sale\\_goods/1980CISG.html](http://www.uncitral.org/uncitral/ar/uncitral_texts/sale_goods/1980CISG.html).

<sup>21</sup> الامم المتحدة، لجنة الامم المتحدة للقانون التجاري الدولي "اليونسترال"، مذكرة تفسيرية ملحقمة بنصوص الاتفاقية، معدة من امانة اليونسترال حول اتفاقية الامم المتحدة بشأن عقود البيع الدولي للبضائع، منشورات الامم المتحدة، نيويورك، 2011، ص35.

<sup>22</sup> هيئة التحكيم التجاري الدولي التابعة لغرفة التجارة الأوكرانية، قرار صادر بتاريخ 21 حزيران/يونيه 2002، منشور في مجموعة السوابق القضائية المستندة إلى نصوص الأونسيتال (كلاوت)، التي تصدر عن لجنة الامم المتحدة للقانون التجاري الدولي، منشورات الامم المتحدة، فيينا، 2011، ص 11. نُشر النص على الموقع الالكتروني <http://cisgw3.law.pace.edu> والخلاصة من إعداد أربان كومان غوبتا حيث ورد فيها "وافق البائع على تسليم المشتري معدات ثمنها 2 500 000 روبل روسي. وكان مطلوباً من المشتري أن يدفع 50 في المائة مقدماً في غضون شهرين من تاريخ توقيع العقد؛ و25 في المائة خلال خمسة أيام من تاريخ صنع المعدات؛ و25 في المائة في غضون خمسة أيام من توقيع شهادة القبول. وسدد المشتري 1 000 000 روبل روسي مقدماً وشحن البائع إلى المشتري معدات تساوي قيمتها 1 350 000 روبل روسي. وتبين أن البضاعة معيبة وأبلغ البائع وطالب البائع بتغريم المشتري على تأخره في الدفع. بذلك. وأصلحت البضاعة جزئياً لاحقاً. ولم يدفع المشتري أي مبالغ أخرى ورفضت هيئة التحكيم المطالبة بموجب المادة 80 من اتفاقية البيع وطبقت الهيئة هذه الاتفاقية لأن كلا البلدين قد صدق عليها. وبمقتضى المادة 80 من الاتفاقية "لا يجوز لأحد الطرفين أن يتمسك بعدم تنفيذ الطرف الآخر لالتزاماته في حدود ما يكون عدم التنفيذ بسبب فعل أو إهمال من جانب الطرف الأول". واعتبرت الهيئة أن النقص والقصور في البضاعة المشحونة دليل على مثل هذا الإهمال من جانب البائع ولذا لم يغرم المشتري على التأخر في السداد".

<sup>23</sup> Susan J. Martin-Davidson, Selling Goods Internationally: The Scope of the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG), September 5, 2008, Southwestern Law School, Los Angeles, United States, P.15. Published on [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1264032](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1264032).

الدولي الخاص إلى تطبيق قانون دولة متعاقدة. وقد تنطبق الاتفاقية أيضاً باختيار الطرفين،<sup>24</sup> وذلك عند إبرام عقد بيع بينهما،<sup>25</sup> بحيث ينصان في عقدهما على أن القانون واجب التطبيق هو قواعد اتفاقية فيينا للبيع الدولي للبضائع.<sup>26</sup> وهذا يعني أن البائع في هذا العقد قد يكون شركة تابعة للقطاع الخاص وكذلك المشتري أو أن يكون أحدهما أو كليهما شخصاً طبيعياً.<sup>27</sup>

21. ولا تشترط الاتفاقية أن يكون أحد أطراف عقد البيع سواء البائع أو المشتري من جنسية تختلف عن الآخر، أو أن يكون تاجراً، فالاتفاقية لاتأخذ بعين الاعتبار في هذا الشأن جنسية الأطراف علاوة على عدم إيلاء الاعتبار لمدى تمتع أحد أطراف عقد البيع الدولي للبضائع بالصفة التجارية للأطراف أو حتى العقد من عدمه كشرط لانطباق الاتفاقية.<sup>28</sup>

22. وسنعرض فيما يلي للشروط الواجب توفرها في عقود البيوع كي تخضع لنطاق تطبيق الاتفاقية.

**الشرط الأول أن يكون العقد عقد بيع لبضاعة:** ويعني البيع في هذا المجال ذلك العقد الذي يلتزم فيه البائع بأن ينقل للمشتري ملكية شيء أو حق مالي آخر في مقابل ثمن نقدي.<sup>29</sup> بيد أن ما يعيننا هو فقط نقل ملكية الشيء دون ملكية الحق الذي يخرج عن نطاق تطبيق الاتفاقية. ونقل ملكية شيء معين يقصد فيه بمفهوم الاتفاقية البضاعة محل التعاقد، وهي قد تتمثل في منقول معين بالذات أو منقول معين بالنوع، فإذا ما كانت البضاعة منما يعتبر منقولات معينة بالذات فإن التزام البائع ينشأ وينفذ فوراً بمجرد إبرام العقد، بينما إذا كانت البضاعة من نوع المنقولات المعينة بالنوع فلا تنتقل الملكية إلا من وقت إفراز هذا الشيء المبيع،<sup>30</sup> فعقد البيع ناقل للملكية حيث أنه يترتب التزاماً في ذمة البائع بنقل ملكية المبيع إلى المشتري،<sup>31</sup> كما يجب أن يتم هذا العقد مقابل ثمن نقدي، لأن انعدام المقابل يجعل من العقد هبة لا بيعاً، علاوة على كون العقد ملزماً للجانبين مولداً للالتزامات بحق كل من طرفيه البائع والمشتري.<sup>32</sup>

انظر: محكمة تحكيم غرفة التجارة الدولية، حكم تحكيم نهائي صادر في القضية رقم 13133، منشور في مجلة التحكيم العالمية ، التي يشرف على نشرها المحامي عبد الحميد الاحدب، العدد 15 سنة 2012، بيروت، 2012، ص 699. حيث يتعلق هذا الحكم التحكيمي بمنازعة حول عقد توريد منتج، وقد نص في هذا العقد على تطبيق اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع "اتفاقية فيينا" حيث ورد في الفقرة الأولى من المادة 24 من العقد "أن العقد خاضع للقانون الموضوعي النافذ في فرنسا ويفسر بموجبه"، وبما أن فرنسا دولة عضو في اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع لسنة 1980 فإن المقصود بالقانون الموضوعي النافذ في فرنسا هو أحكام الاتفاقية باعتبار ذلك تطبيقاً لاختيار الطرفين للقانون الواجب التطبيق. (انظر ص 701 من المرجع السابق).

انظر في تكريس اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع لسنة 1980 كفانون للإرادة وتطبيقها كجزء من القانون الوطني الذي وقع اختيار الأطراف عليه: د. لطف الشاذلي، تعليق على الحكم التحكيمي النهائي الصادر عن محكمة تحكيم غرفة التجارة الدولية، في القضية رقم 13133، منشور في مجلة التحكيم العالمية ، التي يشرف على نشرها المحامي عبد الحميد الاحدب، العدد 15 سنة 2012، بيروت، 2012، ص 730.

انظر في خضوع عقود التجارة الدولية لقانون الإرادة: د. هشام صادق، القانون الواجب التطبيق على عقود التجارة الدولية، منشورات منشأة المعارف، الإسكندرية، 1995، ص 16 وما بعدها والمراجع المشار إليها لديه.

د. أحمد صالح مخلوف، انتقال المخاطر في عقود البيع الدولية، دراسة منشورة في مجلة الحقوق الكويتية الصادرة عن مجلس النشر العلمي بجامعة الكويت، العدد 1 – مارس 2012، منشورات جامعة الكويت، الكويت، 2012، ص 375.

هنالك عقود تبرم بين الدولة من جهة والأشخاص الأجنبية التابعة لدولة أخرى، قد تدخل في ضمن موضوعاتها البيوع الدولية للبضائع. انظر في عقود الدولة د. حفيظة الحداد، العقود المبرمة بين الدول والأشخاص الأجانب، دار النهضة العربية، القاهرة، 1996، ص 11.

انظر المادة 418 من القانون المدني المصري، والمادة 372 من قانون الموجبات والعقود اللبناني

د. محمد حسن قاسم، القانون المدني "العقود المسماة: البيع – التأمين- الإيجار"، دراسة مقارنة، منشورات الحلبي الحقوقية، بيروت، 2008، ص 25.

د. عبدالرزاق السنهوري، الوسيط في شرح القانون المدني الجديد، المجلد 4، العقود التي تقع على الملكية "البيع والمقايضة"، ط 3، منشورات الحلبي الحقوقية، بيروت، 2009، ص 21.

Harry M. Flechtner, Issues Relating to the Applicability of the United Nations Convention on Contracts for the

اما الشرط الثاني فمؤداه ان يكون عقد البيع دولياً:<sup>33</sup> والمقصود بدولية هذا العقد بحسب مفهوم الاتفاقية ان يتم عقد البيع للبضائع بين طرفين يوجد مقر عملهما في دولتين متعاقبتين مختلفتين اي الاتفاقية نافذة بحقهما،<sup>34</sup> أو عندما تقضي قواعد القانون الدولي الخاص إلى تطبيق قانون دولة متعاقدة،<sup>35</sup> دون اشتراط ان يكون احد اطراف عقد البيع سواء البائع او المشتري من جنسية تختلف عن الاخر، اي ان ضابط اختلاف الجنسية بالنسبة للمتعاقدين لا يعد صالحاً كمعيار لتحديد دولية العقد،<sup>36</sup> والعقد بهذا المفهوم ينصرف الى المفهوم الدولي لاتصال عناصره بأكثر من نظام قانوني واحد.<sup>37</sup>

ويتمثل الشرط الثالث في الا يكون البيع من الببوع المستثناة من تطبيق احكام الاتفاقية: استثنت الاتفاقية بعضاً من انواع الببوع وذلك كونها محكومة بقواعد وطنية خاصة نظراً للطبيعة الخاصة لهذه العقود وهي:

أ- عقود البيع المستبعدة بسبب الغرض منها: وهي عقود بيع البضائع التي يكون شراؤها بغرض الاستعمال الشخصي او العائلي او المنزلي،<sup>38</sup> وتعتبر عقود البيع الاستهلاكية مثالا على هذه العقود المستبعدة من نطاق تطبيق الاتفاقية، وذلك لان غرضها تلبية احتياجات استهلاكية ولأغراض شخصية وعائلية او منزلية، ولا يُقصد من اجرائها تحقيق الربح او تنمية حركة التجارة الدولية بشكل مباشر.<sup>39</sup> فمبررات حماية المستهلك ولو كان العقد دولياً تجعل من العقد محكوماً بقواعد حمائية وطنية لان المستهلك يُعتبر الطرف الاضعف في علاقته بالمهني (المحترف) وهو هنا البائع الذي يقدم له السلعة التي يريد التعاقد عليها، ويرجع سبب ضعفه الى كونه يجهل المعلومات الكافية والضرورية حول هذه السلعة والتي تجعله يستخدمها افضل استخدام بما يحقق له الغرض الذي من اجله قام بإبرام العقد.<sup>40</sup> ولا يُفترض في هذا الاطار علم البائع بالغرض الذي يهدف المشتري الى تحقيقه والمتمثل بالاستعمال الشخصي او العائلي او المنزلي، وانما يقع على المشتري عبء هذا اثبات علم البائع بذلك قبل انعقاد العقد او وقته.<sup>41</sup>

International Sale of Goods ("CISG"), Legal Studies Research Paper Series, Working Paper No. 2008-07, University of Pittsburgh School of Law, Pittsburgh, Pennsylvania, United States, April 2008, P.8, This paper can be downloaded from the Social Science Research Network Electronic Paper Collection: <http://ssrn.com/abstract=1118118> or

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1118118&rec=1&srcabs=1264032&alg=1&pos=1](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1118118&rec=1&srcabs=1264032&alg=1&pos=1).

<sup>33</sup> اعتبرت الاتفاقية من قبيل الببوع الداخلة ضمن نطاق تطبيق الاتفاقية عقود التوريد التي يكون موضوعها الاساس صنع بضائع او انتاجها شرط الا يكون مشتري هذه البضائع هو من قام بتوريد العناصر المادية الداخلة في عملية الانتاج

<sup>34</sup> وفي هذا الاطار تنص المادة 10 على انه (في حكم هذه الاتفاقية: أ- إذا كان لأحد الطرفين أكثر من مكان عمل واحد، فيُقصد مكان العمل المكن الذي له صلة وثيقة بالعقد وبتنفيذه، مع مراعاة الظروف التي يعلمها الطرفان أو التي كانا يتوقعانها قبل انعقاد العقد أو وقت انعقاده؛ ب- إذا لم يكن لأحد الطرفين مكان عمل، وجب الأخذ بمكان إقامته المعتاد.

<sup>35</sup> انظر في ضابط الدولية بالنسبة للعقد في اتفاقية فيينا: د. خالد عبد الحميد، فسخ عقد البيع الدولي للبضائع وفقاً لاتفاقية فيينا لعام 1980، اطروحة دكتوراه نوقشت بجامعة القاهرة بتاريخ 2000/12/20، اشراف د.محمود سمير الشرقاوي، البند 10. متاحة الكترونياً على الرابط الإلكتروني

[http://cisgw3.law.pace.edu/cisgarabic/middleeast/abd\\_EI\\_Hamid.htm](http://cisgw3.law.pace.edu/cisgarabic/middleeast/abd_EI_Hamid.htm)

<sup>36</sup> د. محمود سمير الشرقاوي، العقود التجارية الدولية: دراسة خاصة لعقد البيع الدولي للبضائع، دار النهضة العربية، القاهرة، 1992، ص 61.

<sup>37</sup> د. هشام صادق، القانون الواجب التطبيق على عقود التجارة الدولية، منشأة المعارف، الاسكندرية، 1995، ص 59.

<sup>38</sup> الامم المتحدة، لجنة الامم المتحدة للقانون التجاري الدولي "اليونسترال"، مذكرة تفسيرية، المرجع السابق، ص 37.

<sup>39</sup> انظر ديباجة الاتفاقية.

<sup>40</sup> "دراسة في أحكام انظر في مبررات حماية المستهلك من الوجهة القانونية: د. فاتن حوى، الوجيز في قانون حماية المستهلك القانون اللبناني مع الاشارة الى حماية المستهلك المتعاقد عن بُعد "الالكترونيا"، منشورات الحلبي الحقوقية، بيروت، 2012، ص 7.

<sup>41</sup> د. محمد شكري سرور، موجز احكام عقد البيع الدولي للبضائع وفقاً لاتفاقية فيينا 1980، دراسة منشورة في مجلة الحقوق الكويتية الصادرة عن مجلس النشر العلمي بجامعة الكويت، العدد 3 - سبتمبر 1994، منشورات جامعة الكويت، الكويت، 1994،

ب- عقود البيع المستبعدة بسبب طبيعتها: وهي عقود بيع البضائع التي لا تتم بالطرق الاعتيادية للبيع، بل تتم بالمزاد أو عبر تنفيذ الحجز أو البيوع التي تتم بأمر قضائي.

ج- عقود البيع المستبعدة بسبب طبيعة محلها: كبيع الأوراق المالية والأسهم وسندات الاستثمار والصكوك القابلة للتداول والنقود، والسفن والمراكب والحوامات والطائرات، والكهرباء.<sup>42</sup> علاوة على عقود توريد البضائع التي ستصنع أو تنتج إذا تعهد الطرف طالب البضاعة بتوريد جزء كبير من مواد التصنيع أو الانتاج، كما تستبعد عقود توريد البضائع والتي يكون الالتزام الأكبر فيها والواقع على مورد البضائع يتمثل في تقديم الأيدي العاملة أو غير ذلك من الخدمات.<sup>43</sup>

#### رابعاً: المسائل الموضوعية الخاضعة لنطاق الاتفاقية

23. بالإشارة إلى عقد البيع الدولي للبضائع الخاضع لنطاق تطبيق الاتفاقية، فإن هذا العقد يتضمن مسائل موضوعية عديدة تتعلق بهذا العقد منها ما له علاقة بتكوين العقد ومنها ما يتعلق بآثاره ومفاعيله القانونية، ومنها ما يستبعد أساساً من نطاق تطبيق أحكام الاتفاقية.

24. ويقتصر تطبيق هذه الاتفاقية على تكوين عقد البيع والحقوق والالتزامات التي يُنشئها هذا العقد لكلٍ من البائع والمشتري. وهو الأمر الذي سيكون محل عرضنا لاحقاً عند الحديث عن آثار تطبيق اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع 1980 (اتفاقية فيينا)

ص 119.

انظر: محكمة النقض الفرنسية: الدائرة المدنية الأولى، قرار صادر بتاريخ 1 ديسمبر 2010 في دعوى الاستئناف رقم 09-133303Fountain Pajot S.A ، منشور في مجموعة 09-133303Fountain Pajot S.A ، قضية السيد بيتر س والسيدة جولي زوجته ضد شركة السوابق القضائية المستندة إلى نصوص الأونسيفترال (كلاوت)، التي تصدر عن لجنة الأمم المتحدة للقانون التجاري الدولي، (خلاصة الحكم اعداها كلود ويتس و كورين شاتلان)، الأصل بالفرنسية، وقد نُشر النص [www.legifrance.gouv.fr](http://www.legifrance.gouv.fr) بالفرنسية على الموقع التشريعي الحكومي الفرنسي الشبكي: [www.cisg-france.org](http://www.cisg-france.org) وفي قاعدة بيانات اتفاقية البيع [www.courdecassation.fr](http://www.courdecassation.fr)؛ وقاعدة بيانات محكمة النقض [www.cisg-france.org](http://www.cisg-france.org) بفرنسا؛ حيث ورد في <http://www.courdecassation.fr>؛ وقاعدة بيانات محكمة النقض [www.cisg-france.org](http://www.cisg-france.org) بفرنسا؛ الخلاصة " طلب الزوجان، السيد "سين" والسيدة "باء"، وهما يحملان الجنسية الأمريكية، في تموز/يوليه 1999، من الشركة الفرنسية "فونتين باجو" صنع طُوف لاستعمالهما الخاص. غير أن هذا المركب، المشيد في لاروشيل، أتلفته عاصفة قبل تسليمه بعدة شهور. وأجرت الشركة "فونتين باجو" تصليحات عليه كاتمة تلك الواقعة على المشتريين. وإذ تبين للزوجين المذكورين وطلب السيد "سين" والسيدة "باء"، وجود عيوب فيه بُعيد التسليم، رفعا دعوى ضد الشركة البائعة أمام محكمة كاليفورنيا العليا أن ينفذ في فرنسا قرار المحكمة الكاليفورنية الصادر يوم 26 شباط / فبراير 2003 والذي يحكم على الشركة "فونتين باجو" بدفع مبلغ 1 391 650 دولاراً كتعويضات عن عدم التنفيذ

وأكدت محكمة استئناف بواتييه، في قرارها و 1 460 000 دولار كتعويضات تأديبية و 402 084 دولاراً لسداد التكاليف القانونية الصادر بتاريخ 26 شباط/فبراير 2009، حكم محكمة روشفور العليا التي رفضت طلب الأمر بإنفاذ قرار القضاء الكاليفورني. وحسب محكمة استئناف بواتييه، فإن الحكم الكاليفورني مخالف للسياسة العامة الدولية لأن من الجلي أن مبلغ التعويضات التأديبية غير متناسب مع سعر البيع وكذا مقدار التعويضات عن الأضرار المخولة لجبر الضرر الملحق. واستظهرت محكمة الاستئناف، في أن معاً، بالمادة 74 من اتفاقية البيع، التي تقضي بأن تكون التعويضات مساوية للخسارة المتكبدة وللحساب الضائع، وبالقانون الفرنسي الداخلي الذي ينص على أن المسؤولية المدنية الهدف منها هو أن يعاد بالتمام قدر الإمكان إحداث التوازن الذي أخل به الضرر وإعادة الضحية إلى الوضع الذي كانت ستكون عليه لولا وقوع الفعل الضار، وكذا الوفاء بالمبدأ العام ووجه مقدم الطعن الانتباه، في طلبه، إلى كون محكمة بواتييه قد خرقت اتفاقية البيع، ذلك أن هذه. القائل بمنع الإثراء بلا سبب ولم تستجب محكمة. الاتفاقية لا تنطبق على مبيعات المراكب ولا على مبيعات البضائع المشتراة للاستعمال الشخصي أو العائلي النقض لهذا الجزء من البرهان، ممتنعاً بذلك عن تدارك الخطأ الذي ارتكبه محكمة بواتييه بشأن انطباق اتفاقية البيع. كما أن المحكمة أصدرت حكماً عاماً بشأن المدى الذي تنطبق فيه مع السياسة العامة القرارات الأجنبية التي تحكم بدفع تعويضات تأديبية. هكذا وحسب محكمة النقض، "إذا كان مبدأ الإدانة بتعويضات تأديبية ليس منافياً، في حد ذاته، للسياسة العامة، فإنه يكون كذلك متى كان المبلغ المخول غير متناسب من حيث الضرر الملحق وعدم وفاء المُتعهد بالتزاماته التعاقدية". ورفضت محكمة النقض الطلب على أساس أن محكمة بواتييه محقة في "الاستنتاج بأن التعويضات كان من الجلي أنها غير متناسبة لا يمكن بالقياس إلى الضرر الملحق وإلى عدم الوفاء بالالتزامات التعاقدية، بحيث أن الحكم الصادر عن المحكمة الأجنبية الاعتراف به في فرنسا".

انظر المذكرة التفسيرية الخاصة باتفاقية فيينا للبيع الدولي للبضائع.<sup>43</sup>



25. بينما استبعدت الاتفاقية من نطاق تطبيقها على البيع الدولي للبضائع بعض المسائل المتعلقة بهذا البيع، وتتمثل حالات الاستبعاد هذه في عدم انطباق الاتفاقية على المسائل المتعلقة بصحة العقد أو شروطه أو الأعراف المتبعة في شأنه؛ إضافة إلى استبعاد الآثار التي قد يحدثها العقد في شأن ملكية البضائع المباعة من نطاق تطبيق الاتفاقية، كما لا تسري أحكام هذه الاتفاقية على مسؤولية البائع الناتجة عن الوفاة أو الإصابات الجسمية التي تحدث لأي شخص بسبب البضائع.<sup>44</sup>

26. بيد أن هذه المسائل المستبعدة يشوب النص عليها الكثير من الغموض وعدم الوضوح والتناقض، فالنص لا يحدد المقصود بشروط العقد التي تُستبعد من نطاق تطبيق الاتفاقية، وكذلك الأعراف المتبعة بشأن هذا العقد، هل هي الأعراف التجارية أم المدنية، كما أن الغموض يشوب ما قصده المشرع الدولي بعدم انطباق الاتفاقية على صحة العقد، وانطباق الاتفاقية على تكوين العقد مع ما يمثله الترابط بين الصحة والتكوين من أهمية في إبرام عقد البيع الدولي للبضائع.<sup>45</sup>

## المطلب الثاني

### آثار تطبيق الاتفاقية ومقارنتها مع بعض قواعد عقد البيع في القانون المدني القطري

27. رتبت اتفاقية فيينا في حال انطباقها على عقود البيع الدولي للبضائع مجموعة من الآثار، يتعلق بعضها بتكوين العقد وبعضها الآخر بترتيب آثاره القانونية (مفاعيله)، وسيكون هذان الموضوعان محور حديثنا في الفرعين التاليين.

### أولاً: الآثار المتعلقة بتكوين العقد

28. كي يتكون عقد البيع الدولي للبضائع وينعقد – كأى عقد - يجب توفر ثلاثة أركان فيها هي التراضي والمحل والسبب. والتراضي في هذا الإطار يعني التقاء الإيجاب والقبول المتطابقين،<sup>46</sup> الصادرين عن شخص كامل الأهلية لم يشب إرادته أي عيب من عيوب الإرادة كي يكون العقد صحيحاً. أما المحل فيتمثل في الأداء الذي يجب على المدين القيام به لصالح دائئه وهنا في هذا العقد البائع مدين بنقل ملكية المبيع والمشتري مدين بدفع الثمن.<sup>47</sup> أما السبب في العقد فيجب توفره بمفهوم الغرض المباشر الذي يسعى إليه المتعاقدان إضافة إلى الباعث إلى التعاقد وضرورة عدم مخالفتها للنظام العام مالا داب وهذا ما نحيل بشأنه إلى القواعد العامة في القانون المدني.<sup>48</sup>

29. وسوف نعرض في هذا الإطار للتراضي والمحل في عقد البيع الدولي للبضائع والذي بدونهما لا يتكون هذا العقد.

### 1- التراضي :

30. يُعتبر عقد البيع الدولي للبضائع من العقود الرضائية التي تنعقد بمجرد تبادل البائع والمشتري التعبير عن إرادتهما بقصد انشائه دونما حاجة إلى إفراغ هذا التراضي في شكل خاص، ولعل ذلك الأمر يعتبر من

<sup>44</sup> انظر نص المادة 4 و 5 من الاتفاقية.

<sup>45</sup> د. محمد شكري سرور، موجز أحكام عقد البيع الدولي للبضائع وفقاً لاتفاقية فيينا 1980، المرجع السابق، ص 122.

<sup>46</sup> Ramazan ORLU, Formation of the contract under the Vienna Convention on Contracts for the International Sale of Goods 1980 (CISG) in comparison with Turkish Code of Obligations. November 2012, published on <http://www.egov.ufsc.br/portal/conteudo/united-nations-convention-contracts-international-sale-goods-cisg>

<sup>47</sup> د. محمد حسن قاسم، القانون المدني "العقود المسماة: البيع – التأمين- الإيجار"، المرجع السابق، ص 67.

<sup>48</sup> انظر د. مصطفى الجمال ود. رمضان أبو السعود ود. نبيل سعد، مصادر وأحكام الالتزام، منشورات الحلبي الحقوقية، بيروت، 2003، ص 156.

ادوات تحقيق التوازن العقدي بين طرفي عقد البيع الدولي،<sup>49</sup> حيث تنص الاتفاقية على عدم اشتراط تمام انعقاد عقد البيع أو إثباته كتاباً، وعدم خضوعه لأي شروط شكلية، علاوة على جواز إثباته بأي وسيلة بما في ذلك الإثبات بالبينة<sup>50</sup>. وسوف نعرض فيما يلي لعنصري التراضي المتمثلين بالايجاب والقبول.

#### أ- الايجاب:

31. حددت المادة 14 المقصود بالايجاب كعنصر من عناصر التراضي لتكوين العقد والشروط الواجب توافرها فيه، فاعتبرت الايجاب أي عرض لإبرام عقد إذا كان موجهاً إلى شخص أو عدة أشخاص معيّنين، وكان هذا الايجاب محدداً بشكل كاف اي متضمناً كافة البيانات المتعلقة بالكمية والنوع والتمن، وتبين منه اتجاه قصد الموجب إلى الالتزام به في حالة القبول. كما حددت الاتفاقية معنى التحديد الكافي الواجب توفره في العرض المعتبر ايجاباً واعتبرت العرض محدداً بشكل كاف إذا عيّن البضائع ( بما يشمل مواصفاتها بما تميزها عن غيرها) وتضمن صراحةً أو ضمناً تحديداً للكمية والتمن أو بيانات يمكن بموجبها تحديدهما.
32. وتطبيقاً لمفهوم الايجاب بحسب المادة 14 من اتفاقية البيع الدولي للبضائع فقد قضت لجنة الصين الدولية للتحكيم الاقتصادي والتجاري في حكم تحكيمي صادر عنها - وبمناسبة نزاع حول عقد بيع مبرم بين بائع صيني ومشتري استرالي لبيع اقراص فيديو رقمية- بوجود العقد وصحته وفقاً للنظام القانوني الساري في الصين بما يشمل قانون العقود الصيني وذلك اتفاقية البيع الدولي للبضائع.

33. بيد ان الاتفاقية في الفقرة الثانية من المادة 14 تبدو وكأنها خرجت عن القواعد العامة في القانون المدني التي تعتبر العرض بالموصفات السابقة ايجاباً، واعتبرته اي الاتفاقية مجرد دعوة للتعاقد الا اذا تبين من الظروف انه يعد ايجاباً، فالاصل حسب الاتفاقية ان العرض بالتحديد السابق لا يعد ايجاباً الا اذا تبين من ظروف واقع الحال انه ايجاب بحيث ان صادفه قبول لا يعد العقد منعقداً ما لم تشر الى ذلك الظروف المحيطة بالعقد، والعكس هو المعمول به في القواعد العامة للقانون المدني والتي تعتبر العرض المحدد المتضمن كافة عناصر العقد المراد ابرامه بمثابة الايجاب الذي ان صادفه قبول مطابق انعقد العقد.<sup>51</sup> ولعل هذا المنحى العام نجده في القانون المدني القطري حيث يعتبر من قبيل الايجاب "عرض البضائع مع بيان أثمانها، دون إخلال بما تقتضيه قواعد التجارة" اما بشأن "النشر والإعلان وإرسال أو توزيع قوائم الأسعار الجاري التعامل بها، وكل بيان آخر متعلق بعروض أو طلبات موجه للجمهور أو لأفراد معينين" فلا تعتبره ذات المادة إيجاباً بالمعنى القانوني المرتب لآثار قانونية، الا في حالة كان هنالك من الدلائل القوية المرتبطة بظروف الحال ما يؤكد على اعتبار هذه الأفعال من قبيل الايجاب.<sup>52</sup> وفي هذا الاطار فإن عقد البيع ينعقد كما في بقية العقود بمجرد التقاء الايجاب بالقبول بحسب ما نصت عليه المادة 64 من القانون المدني القطري حيث اشارت الى ان انعقاد العقد "بمجرد ارتباط الإيجاب بالقبول"، على اعتبار ان الايجاب هو التعبير الأول والجازم والبات الذي يصدر عن احد المتعاقدين متضمناً رغبة محددة في التعاقد متضمنة كافة عناصر هذا التعاقد (وليكن هنا الشخص الذي يود بيع بضاعة معينة)، بحيث ان صادف هذا الايجاب قبول مطابق ممن وجه اليه الايجاب (الشخص الذي ربما سيشتري البضاعة) انعقد العقد، اما ان كان هنالك ثمة تعديل من قبل من وجهت

د. وفاء مصطفى عثمان، توازن المصالح في عقد البيع الدولي للبضائع وفقاً لاتفاقية فيينا 1980، اطروحة دكتوراه، جامعة القاهرة، 2005، ص136.

المادة 11 من الاتفاقية.

نص المادة 14 فقرة 2 من اتفاقية فيينا (ولا يُعتبر العرض الذي يُوجّه إلى شخص أو أشخاص غير معيّنين إلا دعوة إلى الإيجاب ما لم يكن الشخص الذي صدر عنه العرض قد أبان بوضوح عن اتجاه قصده إلى خلاف ذلك).

المادة 69 من لاقانون المدني القطري



الدعوة اليه بالتعاقد فلا يكون التعبير الصادر عن الشخص الأول إيجاباً وإنما هذا التعديل الأخير هو الإيجاب الجديد الذي ينتظر قبولاً من الشخص الموجه اليه وهو الشخص الأول.<sup>53</sup>

34. ولمحاولة إيجاد مواعمة بين الحلول التي وضعتها اتفاقية فيينا وتلك الحلول الموجودة في القواعد العامة للقانون المدني، ولا اعتبارات التجارة الدولية المرتبطة بعقد البيع الدولي للبضائع فإننا نرى أن التباين الحاصل بين هذين المنحيين هو ظاهري، ويجب تفسيره على أن الاتفاقية تشترط في العرض المقدم من قبل الشخص العارض كي يكون إيجاباً شروطاً تتمثل في تحديد موضوع العرض بدقة وخلوه من الالتباس حول الموضوع علاوة على ثبات معالم موضوع العرض وتحديد بياناته بدقة إضافة إلى أن يكون العرض معبراً عن إرادة التعاقد الملزمة لمن صدرت عنه والتي عبرت عنها الاتفاقية بعبارة أن يكون الشخص الذي صدر عنه العرض قد أبان بوضوح عن اتجاه قصده، فإن توفرت هذه الشروط اعتبر العرض إيجاباً بمفهوم الاتفاقية وحتى بمفهوم القواعد العامة في القانون المدني.<sup>54</sup>

35. وتبين الاتفاقية الأحكام الخاصة بالإيجاب خاصة لجهة مفاعيله القانونية وتوقيت ترتيب هذه المفاعيل، حيث أشارت المادة 15 إلى أن الإيجاب يحدث أثره عند وصوله إلى المخاطب، أي أن الإيجاب وقبل وصوله إلى من وجه إليه لا أثر له حيث يستطيع من أصدره سحبه، أو الرجوع عنه أو تغييره بإيجاب آخر طالما لم يصل الإيجاب إلى المخاطب به وحتى صدور القبول عنه.<sup>55</sup> بيد أن مصدر الإيجاب أو الموجب لا يستطيع الرجوع عن إيجابه في حال كان الإيجاب ملزماً، وتتحقق حالة الإيجاب الملزم إذا قيد الموجب نفسه بمدة لا يحق له خلالها الرجوع عن إيجابه أو إذا تبين من العقد أن الموجب قد انصرفت إرادته إلى تقييد نفسه بعدم الرجوع عن إيجابه إلا إذا أصدر من وجه إليه الإيجاب جوابه بقبول العرض المقدم من الموجب وحينها ينعقد العقد،<sup>56</sup> أو رفض الإيجاب وحينها ينقضي التزام الموجب بالابقاء على إيجابه.<sup>57</sup>

### **ب- القبول:**

36. عرضت المادة 18 من الاتفاقية لمفهوم القبول الذي بوصوله إلى علم الموجب ينعقد عقد البيع الدولي للبضائع، وفي هذا الإطار فإن أي بيان أو أي تصرف آخر صادر من المخاطب يُفيد الموافقة على الإيجاب يعتبر بهذا التحديد قبولاً، والمقصود بذلك أن القبول يمكن أن يصدر صراحة باللفظ أو الكتابة أو الإشارة أو اتخاذ موقف لا تدع ظروفاً الحال مجالاً للشك في دلالاته الصريحة على القبول، كما يمكن أن يصدر القبول ضمناً كما لو بادر الطرف المخاطب بالإيجاب بارسال البضاعة التي طلبها الموجب، بحيث يعتبر تنفيذ العقد دلالة ضمنية على قبوله وبالتالي انعقاده.

37. بيد أن الاتفاقية تقرر أن السكوت لا يصلح بأن يكون قبولاً للإيجاب في مجال عقد البيع الدولي للبضائع باعتباره موقفاً سلبياً متجرداً من أي دلالة للتعبير عن إرادة من وجه إليه الإيجاب بقبول هذا الإيجاب، إضافة إلى أن عدم القيام بأي تصرف لا يُعتبر في ذاته قبولاً يعتد به لانعقاد العقد. ولعل عبارة (في ذاته)

د. حسن البرواي، العقود المسماة في القانون المدني القطري - الكتاب الأول: عقد البيع، دار النهضة العربية، القاهرة، 2014، ص 59<sup>53</sup>

د. مصطفى العوجي القانون المدني - ج 1 - العقد، ط 2، دار الخلود للنشر، بيروت، 1999، ص 233.<sup>54</sup>

المادة 16 من الاتفاقية الفقرة 1.<sup>55</sup>

تنص المادة 165 من قانون الموجبات والعقود اللبناني على أن الاتفاق هو كل التنازل بين مشيئة وأخرى لإنتاج مفاعيل قانونية، وإذا كان يرمي إلى إنشاء علاقات الزامية سمي عقداً.<sup>56</sup>

د. حيدر فليح حسن، لحظة انعقاد العقد طبقاً لاتفاقية الأمم المتحدة الخاصة بعقود البيع الدولي للبضائع ١٩٨٠ (دراسة مقارنة مع بعض التشريعات العربية والأجنبية)، بحث منشور في مجلة العلوم القانونية الصادرة عن جامعة بغداد، العدد 2 لسنة 2010، منشورات جامعة بغداد، بغداد، 2010، ص 22.<sup>57</sup>

الواردة في ختام الفقرة الاولى من المادة الثامنة عشرة من الاتفاقية تنصرف في تفسيرها الى ان هنالك نوعا من انواع السكوت قد يعتبر قبولا للإيجاب وهو السكوت الذي ترتبط به ظروف تجعل منه قبولا للإيجاب، وهو ما يُعرف بالسكوت المُلابس، اي السكوت الذي يرتبط مثلا بطبيعة المعاملة او العرف التجاري، او السكوت المرتبط بوجود تعامل سابق بين من وجه الإيجاب وبين من يفترض فيه ان يقبل بسكوته، علاوة على السكوت المرتبط بمنفعة الشخص الساكت الذي وجه اليه الإيجاب.<sup>58</sup>

38. وكى يُحدث القبول اثره القانوني فلا بد من وصوله الى الموجب بما يُفيد الموافقة، والاثر القانوني المعني في هذا السياق هو انعقاد عقد البيع الدولي للبضائع، وتقرر الاتفاقية بأن القبول لا أثر له إذا لم يصل إلى الموجب خلال المدة التي اشترطها هذا الاخير، أو خلال مدة معقولة في حالة عدم وجود مثل هذا الشرط، على أن يؤخذ في الاعتبار ظروف الصفة وسرعة وسائل الاتصال التي استخدمها الموجب. وفي حال كان التعبير عن القبول شفاهاة فإن اثره يكون لازماً في الحال بما يؤدي لانعقاد العقد ما لم يتبين من الظروف خلاف ذلك.

39. ولعل الاتفاقية في الفقرة الثالثة من المادة 18 اعطت للاعراف التجارية والتعاملات السابقة بين الطرفين اهمية في مجال البيع الدولي للبضائع، فقد اجازت في هذه الاحوال أن يُعلن المخاطب الذي عُرض عليه الإيجاب عن قبوله بالقيام بأي تصرف كإرسال البضائع أو تسديد الثمن، دون إخطار الموجب، عندئذ يكون القبول نافذاً في اللحظة التي تم فيها التصرف المذكور بشرط أن يجرى ذلك خلال المدة المحددة او المعقولة لوصول القبول الى من صدر عنه الإيجاب.<sup>59</sup>

40. ويُشترط في القبول مطابقته التامة للإيجاب،<sup>60</sup> والمطابقة تكون في كل ما ورد به وبما لا يتضمن رفضاً للإيجاب ويُشكّل إيجاباً مقابلاً يحتاج بدوره لقبول مطابق كي ينعقد العقد.<sup>61</sup>

41. وتضع المادة 72 من القانون المدني القطري ضوابط القبول المشار اليها حيث يشترط لانعقاد العقد أن يكون القبول مطابقاً للإيجاب، بحيث انه لو أتى جاء الرد على الإيجاب بما يغير فيه من زيادة عليه او نقصان او تعديل ، فإنه لا يعد "قبولا" يعتد به لانعقاد العقد بل يعد حينها "إيجاباً" جديداً يفترض ان يلاقيه قبول كي ينعقد العقد .

42. وقد اشارت الاتفاقية الى ما يمكن اعتباره تعديلا جوهريا في متضمنات الإيجاب من قبل من وجه اليه هذا الإيجاب، وبحيث لا يعتبر ما يصدر عنه قبولا بل ايجابا جديدا بحاجة لقبول، ويتمثل ذلك في الشروط الإضافية أو المختلفة المتعلقة بالثمن أو التسديد أو النوعية أو الكمية أو مكان وموعد التسليم للبضائع،<sup>62</sup> أو ما يتعلق بمدى مسؤولية أحد الطرفين تجاه الطرف الآخر أو تسوية المنازعات، بحيث اشارت الاتفاقية الى اعتبار هذه الأمور تُؤدّي إلى تغيير أساسي بما جاءت به صيغة الإيجاب وبالتالي تنتفي عنها صفة القبول.

<sup>58</sup> في تطبيقات فكرة السكوت الملابس: انظر د.نبيل سعد، النظرية العامة للالتزام - ج1 - مصادر الالتزام في القانون اللبناني والتشريعات العربية، دار النهضة العربية للطباعة والنشر، بيروت، 1995، ص88.

<sup>59</sup> د.محمد قاسم ، القانون المدني، المرجع السابق، ص74.

<sup>60</sup> انظر في مفهوم مطابقة القبول للإيجاب: العميد د.عبدالمعظم فرج الصدة، نظرية العقد في قوانين البلاد العربية، دار النهضة العربية للنشر، بيروت، 1974، ص97.

<sup>61</sup> انظر المادة 19 من الاتفاقية.

<sup>62</sup> د.رمضان ابو السعود، دروس في العقود المسماة "عقد البيع في القانون المصري واللبناني"، الدار الجامعية للنشر، بيروت، 1985، ص58.

43. على أنه يحق للشخص مُصدر القبول ان يقوم بسحب قبوله كالما لم يصل الى علم الموجب، اي طالما لم ينقذ العقد.<sup>63</sup>

44. وفي هذا الاطار لانجد أي مانع من ان يشير القانون المدني القطري الى ما يتضمن الاخذ باتفاقية فيينا الخاصة بالبيع الدولي على اعتبار انه لا تتضمن أي تعارض مع فلسفة القواعد المنظمة لعقد البيع، لا بل ان من شأن الانضمام الى اتفاقية البيع الدولي توحيد الحلول القانونية الخاصة بهذا النوع من المعاملات، وبما يحقق حافزا للمستثمرين الأجانب بأن البيع الدولي ستطبق أحكامه كما لو ان القانون الأجنبي الذي يأخذ فيه عد منطبقا، ودون اللجوء الى منهج تنازع القوانين في العلاقات الخاصة الدولية.

## 2- المحل: المبيع والتمن

45. يُعتبر المبيع محل التزام البائع ويجب ان يتوفر في هذا المحل الشروط المتطلبة في القواعد العامة لجهة وجود هذا المبيع او قابليته للوجود كما لو كانت البضاعة محل عقد البيع لازالت في طور التصنيع ، وتعيين هذا المحل او قابليته للتعيين عبر تعيين هذا المحل تعيينا كافيا فغن كان من الاشياء القيمية يجب بيان صفاته بشكل ناف للجهة اما اذ كان من الاشياء المثلية فإن التعيين الكافي بشأنها يكون بتحديد جنسها ونوعها ومقدارها، كما يشترط في محال العقد جواز التعامل فيه وملكية البائع للمبيع محل عقد البيع الدولي للبضائع.<sup>64</sup>

46. اما لجهة الثمن فهو محل التزام المشتري والذي يجب عليه تنفيذه وفقا للطريقة المتفق عليها في عقد البيع الدولي للبضائع، فقد يكون الوفاء بالثمن نقدا او بموجب شيك او قد يكون على دفعات متعددة او دفعة واحدة او مرتبا مدى الحياة.

47. وفي هذا الاطار فإن القانون المدني القطري أشار في المواد 421 الى 427 الى ضوابط تعيين المبيع وكذا الثمن، حيث اشترط العلم الكافي للمشتري بالمبيع مع احتفاظه بالحق في طلب ابطال عقد البيع، كما وضع المشرع القطري في هذا الاطار الضوابط التي من خلالها يمكن القول بتوافر "العلم الكافي بالمبيع وهي ضرورة ان يتضمن العقد بيانا بالمبيع من شأنه ان يجعل المشتري يعرف هذا المبيع معرفة نافية للجهالة وان يكون على علم بكافة الاوصاف الأساسية له. كما وضع المشرع القطري احكاما تفصيلية متعلقة بالبيع بالعينة التي اشترط وجوب مطابقة المبيع للعينة التي تم الاتفاق عليها، وكذلك احكاما للبيع بشرط التجربة الذي يمنح فيه المشتري مكنة قبول المبيع او رفضه بعد ان يمكنه البائع من ممارسة حقه في تجربة المبيع على ان يتم ذلك خلال المدة المتفق عليها في حال وجود اتفاق على المدة او خلال مدة معقولة للتجربة في حالة غياب الاتفاق على المدة.

ولجهة الاتفاق على الثمن فقد أجاز المشرع القطري اقتصار تحديده على وضع الأسس الصالحة لتقدير الثمن دون تطلب تحديده بشكل بات عند انعقاد العقد، ولم يرتب على عدم ذكر الثمن في عقد البيع بطلان هذا العقد على اعتبار وجود أسس موضوعية لتقديره او ان تحديده خاضع لسعر السوق او لما يقتضيه عرف التعامل في هذه الحالات . ولعل هذا التوجه مرده الحفاظ على البعد الاقتصادي للعقد بدل محاولة انهاء الروابط العقدية المتضمنة في عقد البيع.

<sup>63</sup> د.محمد سرور، موجز احكام عقد البيع الدولي للبضائع، المرجع السابق، ص132.

<sup>64</sup> د.محمد قاسم، القانون المدني، المرجع السابق، ص157 وما يليها.

## ثانياً: الآثار المتعلقة بترتيب مفاعيل العقد

48. يتناول الجزء الثالث من الاتفاقية ترتيب بعض مفاعيل عقد البيع الدولي للبضائع المتمثلة بالتزامات الطرفين في العقد. وتشمل التزامات البائع تسليم البضائع بالكمية والنوعية المنصوص عليهما في العقد، فضلاً عما يتصل بذلك من مستندات، ونقل الملكية في البضائع. أما التزامات المشتري فتشمل دفع ثمن البضائع واستلامها. وإضافة إلى ذلك، فإن هذا الجزء من الاتفاقية يورد قواعد مشتركة بشأن سبل الانتصاف المتعلقة بالإخلال بالعقد ويعني ذلك القواعد المتعلقة بحل المنازعات في حال ثارت نتيجة الإخلال بتنفيذ العقد من قبل أحد طرفيه. واجازت الاتفاقية للطرف المتضرر أن يشترط الوفاء بالعقد أو يطالب بتعويضات أو يفسخ العقد في حال الإخلال بالتزامات جوهرية أو أساسية فيه. كما عرضت الاتفاقية في هذا الجزء منها لأحكام انتقال التبعة، والإخلال المتوقع بالعقد، والتعويضات، والإعفاء من تنفيذ العقد.<sup>65</sup>
49. وفي القانون المدني القطري خصصت المواد من 432 الى 465 لتناول الأثر المترتبة على عقد البيع فيما يتعلق بالبائع محددة التزامات البائع، مع التركيز على ان تنفيذ هذه الالتزامات يجب ان يكون كما هو متفق عليه وبحسن نية وبما يضمن تحقيق الغاية النهائية من عقد البيع.
50. حيث يجب على البائع القيام بالإجراءات الضرورية اللازمة لنقل الملكية الى المشتري، وليس هذا وحسب بل يجب عليه أيضاً الامتناع عن أي إجراء او عمل من يؤدي الى استحالة نقل الملكية او عرقلة هذه الامر . يضاف الى ذلك التزام البائع تسليم المبيع للمشتري طبقاً للمواصفات المتفق عليها وبالحالة التي كان عليها وقت ابرام عقد البيع، إضافة الى تسليمه ملحقات المبيع وما يعد من اجزائه، حيث يلحق بالمبيع الوثائق والمستندات المتعلقة به، كما حدد المشتري ضوابط التسليم المعتمد به للقول بتنفيذ هذا الالتزام من عدمه.
51. كما اوجب المشرع على البائع تزويد المشتري بكافة البيانات الضرورية الخاصة بالمبيع وبما يحقق قيام البائع بتنفيذ التزامه بالادلاء بالبيانات الضرورية الخاصة بالمبيع بما يجع من المشتري عالماً بهذه البيانات " تنفيذ الالتزام بالاعلام"، علاوة على ما تقتضيه بعض عقود البيع من تنفيذ التزام اخر مرتبط هو الالتزام بالتبصير والتحذير لو تطلب المبيع عناية خاصة في استعماله تجنباً لحصول اضرار قد تلحق بالمشتري جراء عدم إيلاء العناية المطلوبة الاهتمام الواجب عند استعمال بعض المنتجات.
52. واستقرارا للتعاملات حدد المشرع المدة التي من خلالها يحق رفع الدعوى الخاصة بطلب فسخ العقد أو إنقاص الثمن أو تكملته أو رد الزيادة بحيث جعل الحق في رفع هذه الدعوى يتقادم في حال انقضت سنة من وقت تسليم المبيع تسليماً فعلياً، محدداً تبعة الهلاك قبل التسليم وبعده.
53. كما تضمنت المواد المشار إليها سالفاً كافة الالتزامات الملقة على عاتق البائع والتي عرضت لها اتفاقية البيع الدولي كالالتزام بضمان الاستحقاق والتعرض والعيوب الخفية.
54. وفي هذا الاطار فقد عرض المشرع القطري لالتزامات المشتري في المواد 466 الى 473 ضمناً حيث عرض أولاً لالتزام المشتري بدفع الثمن وضوابط تنفيذ هذا الالتزام لجهة توقيته وكيفيته ومكان الوفاء به. فالثمن يكون مستحق الوفاء بمجرد تمام البيع فوراً، غير ان هذه القاعدة لاتعد من قبيل القواعد الامرة، حيث أجاز المشرع الخروج عليها في حال وجود اتفاق مخالف ، او ان عرف التعامل كان يقضي بغير هذا الحكم ، مع الاحتفاظ بحق المشتري بحبس الثمن في حالات تعرض احد للمشتري او في حالات وجود

<sup>65</sup> انظر المذكرة التفسيرية الملحقه بالاتفاقية.

أسباب جدية يخشى ان تؤدي لاستحقاق المبيع، او في حالة ظهور عيب في المبيع، غير ان هذا الحق مشروط بعدم وجود اتفاق في العقد مانع من هذه المكنة.

كما يتوجب على المشتري القيام بتسلم المبيع - وهو التزام مقابل لالتزام البائع بتسليم المبيع - والتسلم يكون في مكان وجود المبيع وقت البيع، الا في حال وجود اتفاق على غير ذلك او عرف قضى بغير هذا الامر حينها يقدم الاتفاق والعرف على الترتيب ، على ان يتحمل المشتري "نفقات عقد البيع ورسوم التسجيل ونفقات الوفاء بالثمن وتسلم المبيع وغير ذلك من مصروفات، ما لم يوجد اتفاق أو عرف يقضي بغير ذلك".

55. وهناك ثمة اثار تتعلق بكل من البائع والمشتري معا ، فالاتفاقية تفرض بموجب عقد البيع الدولي للبضائع على اطراف هذا العقد الالتزام بحفظ البضائع طالما كانت في عهده وللطرف الاخر حقوق متعلقة بها. كما ان الاتفاقية تعرض لتبعة الهلاك،<sup>66</sup> لتجعل الهلاك أو التلف الذي يحدث للبضائع بعد انتقال التبعة إلى المشتري على عاتق هذا المشتري ولا يعفيه ذلك من التزامه بدفع الثمن ما لم يكن الهلاك أو التلف ناتجا عن فعل البائع أو تقصيره.<sup>67</sup>

56. وتحدد المادة 74 من الاتفاقية اسس التعويض في حال الاخلال بالالتزامات العقدية الناشئة عن عقد البيع الدولي للبضائع،<sup>68</sup> حيث يتألف التعويض من مبلغ يُعادل الخسارة التي لحقت بالطرف المتضرر، علاوة على الكسب الذي فاتته نتيجة لهذا الاخلال.<sup>69</sup> بيد ان هذه المادة وضعت حدوداً للتعويض ألا يتجاوز التعويض قيمة الخسارة والربح الضائع التي توقعها الطرف المخالف أو التي كان ينبغي له أن يتوقعها وقت انعقاد العقد في ضوء الوقائع التي كان يعلم بها أو التي كان من واجبه أن يعلم بها كنتائج متوقعة لمخالفة العقد المتمثلة بالاخلال بالتزامه العقدي.<sup>70</sup>

57. وتضع الاتفاقية بعض الاحكام الخاصة بالاعفاء من المسؤولية عن الاخلال بالالتزامات العقدية، حيث تشير المادة 79 الى عدم مسؤولية اي من الطرفين عن عدم تنفيذ أي من التزاماته إذا أثبت أن عدم التنفيذ كان بسبب عائق يعود إلى ظروف خارجة عن إرادته وأنه لم يكن من المتوقع بصورة معقولة أن يأخذ العائق في الاعتبار وقت انعقاد العقد أو أن يكون بإمكانه تجنبه أو تجنب عواقبه أو التغلب عليه أو على عواقبه، وهذا يعني القوة القاهرة او الحادث المفاجئ الذي لا يمكن توقعه او توقيه، والذي لا يعد سببا اجنبيا لايد لاي من الاطراف المتعاقدة فيه.

<sup>66</sup> Dr. Michael C. Mineiro, CISG and the Final Frontier: Contracting for the International Sale of Goods that Originate from, are Delivered in, or Transit through Outer Space and the Passage of Risk of Loss, Institute of Air and Space Law, McGill University- Montreal, Canada, October 3, 2008, P.4. Electronic copy available at: <http://ssrn.com/abstract=1285608>.

<sup>67</sup> المادة 66 من الاتفاقية

<sup>68</sup> Locknie Hsu, Remedies Available for Breach of Contract under the UN Convention on Contracts for the International Sale of Goods, Singapore Academy of Law Journal, Vol. 8, p. 115, 1996, Singapore, Published on [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=696521](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=696521).

<sup>69</sup> John Y. Gotanda, Damages in Lieu of Performance Because of Breach of Contract, Villanova University School of Law, Public Law and Legal Theory Working Paper Series, Villanova University School of Law, Villanova, United States, Working Paper No. 2006-8, July 2006, P53. This paper can be downloaded from the Social Science Research Network Electronic Paper Collection at <http://ssrn.com/abstract=917424> or [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=917424&rec=1&srcabs=696521&alg=1&pos=1](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=917424&rec=1&srcabs=696521&alg=1&pos=1).

<sup>70</sup> Eric C. Schneider, Measuring Damages Under the CISG - Article 74 of the United Nations Convention on Contracts for the International Sale of Goods, Pace International Law Review, Vol. 9, No. 1, p. 227, Summer 1997, University of Baltimore - School of Law, Baltimore, United States, 1997, Available at: <http://digitalcommons.pace.edu/pilr/vol9/iss1/7>.

58. كما تفرض الاتفاقية بموجب المادة 25 على كل من طرفي عقد البيع الدولي عدم ارتكاب اي مخالفة جوهرية للعقد،<sup>71</sup> ويُقصد بالمخالفة الجوهرية لمقتضيات العقد اي مخالفة يرتكبها اي طرف في العقد ويكون من شأنها إلحاق الضرر بالطرف الاخر شريطة ان يتمثل هذا الضرر في حرمان الطرف المضرور مما كان يحق له أن يتوقع الحصول عليه بموجب العقد، بمعيار الرجل العادي في ذات الظروف . وقد اعتبر القضاء الفرنسي عدم احترام احد اطراف العقد لمقاصد الطرف الاخر من وراء ابرام العقد بمثابة الخرق الاساسي للعقد طبقا للمادة 25 من الاتفاقية اي من قبيل المخالفة الجوهرية.<sup>72</sup>

59. وفي هذا الاطار فقد عرض القانون المدني القطري في المادة 172 لموجب أساس ملقى على عاتق اطراف العقد سواء كان البائع او المشتري وهو التزام أساسي في كل العقود يبدأ من مرحلة التفاوض وحتى الانتهاء من تنفيذ العقد وهو " الالتزام بحسن النية" ان في التفاوض او في الابرام او في التنفيذ او حتى اثناء النزاع حول تنفيذ العقد.<sup>73</sup>

### الخاتمة: خلاصات ونتائج البحث

60. تأتي اتفاقية الأمم المتحدة بشأن عقود البيع الدولي للبضائع (اتفاقية فيينا للبيع الدولي) لسنة 1980 – كما عرضنا - لوضع اطار قانوني موحد بشأن إبرام عقود البيع الدولي للبضائع، ولتحقيق التوازن المنشود بين مصالح اطرافه المشتري والبائع. وقد حاولنا من خلال دراستنا هذه التعرف على اهمية وضع اطار قانوني محكم الامم المتحدة من خلال اليونسسترال ان تجعله نظاما موحد لتوحيد الحلول القانونية، واهمية انضمام الدول الى هذه الاتفاقية باعتبارها اطار تشريعيا يوفر الثبات التشريعي المنشود في مجال بيع البضائع دوليا.

61. من هنا فإن نظرة فاحصة لهذه الاتفاقية تجعل من الاهمية بمكان القول بضرورة انضمام الدول اليها لتوحيد الحلول في مجال هو الابرز في ميدان التجارة الدولية.<sup>74</sup> ومن هنا نوجه الدعوة الى المشرع القطري بضرورة سرعة الانضمام الى اتفاقية البيع الدولي وادماج احكامها في القانون المدني القطري بحيث ينص في هذا القانون بشأن عقود البيع على مايلي: - يضاف بند (سابعا) بعد المادة 487 تحت عنوان ( البيع الدولي ) تحدد فيه :

- تعريف عقد البيع الدولي

<sup>71</sup> Alysha SALINGER, The United Nations Convention on Contracts for the International Sale of Goods (CISG): What is the Relevant Time of Foreseeability in Article 25?, Research Thesis, Submitted in fulfilment of the requirements for 76040 Research Thesis, Autumn Semester 2011, Faculty of Law at the University of Technology, Sydney, Supervisor: Dr John Felemegas, Faculty of Law at University of Technology Sydney, Sydney, 2011, P.29. Published on <http://www.cisg.law.pace.edu/cisg/biblio/salinger.pdf>.

<sup>72</sup> انظر: محكمة استئناف غرونوبل الفرنسية: الدائرة التجارية، قرار صادر بتاريخ 22 فبراير 1995 في قضية شركة سارل بري برودكشن ضد شركة بان افريكا اكسبورت، منشور في مجموعة السوابق القضائية المستندة إلى نصوص الأونسسترال (كلاوت) ، التي تصدر عن لجنة الامم المتحدة للقانون التجاري الدولي، منشورات الامم المتحدة، فيينا، 1996، ص 7. متاح [http://www.uncitral.org/uncitral/ar/case\\_law.html](http://www.uncitral.org/uncitral/ar/case_law.html) الالكتروني على الرابط الالكتروني

<sup>73</sup> محمود دودين، الاخلاص المبستر للعقد: تحليل مقارنة بين الوثائق الدولية الموحدة للبيوع والقانونين المدني والتجاري القطريين، دراسة منشورة في المجلة الدولية للقانون الصادرة عن كلية القانون بجامعة قطر، العدد الأول – 2015، متاحة الكترونيا على ص 7. تاريخ اخر زيارة 8 يناير 2017. <http://www.qscience.com/doi/pdf/10.5339/irl.2015.6>

<sup>74</sup> وعلى غرار هذه الاتفاقية اتت نصوص مبادئ اليونيدروا كمحاولة لتوحيد المبادئ القانونية المتصلة بعقود التجارة الدولية، انظر: د. أمين دواس، نطاق تطبيق مبادئ اليونيدروا لعام 2004 على عقود التجارة الدولية، بحث منشور في مجلة الحقوق الكويتية، الصادرة عن مجلس النشر العلمي بجامعة الكويت، العدد 2- يونيو 2008، منشورات جامعة الكويت، الكويت، 2008، ص 392 والمراجع المشار اليها لديه.

- نطاق هذا العقد
- اطرافه
- القيمة القانونية لتبادل العرض وقبوله
- التزامات الطرفين في العقد
- الاثار المترتبة عن الإخلال بالعقد
- تبعة الهلاك وانتقالها
- اثر الإخلال المتوقع بالعقد
- التعويضات
- الإعفاء من تنفيذ العقد
- مدى تطلب الشككية في هذا العقد .

## *Session 12 — Approaches to keeping UNCITRAL texts up to date*

### *Small and Medium Sized Enterprises and public procurement regulation: the division of public contracts into lots*

*Martin Trybus, University of Birmingham, United Kingdom*

Small and Medium-Sized Enterprises (SME) are at the **heart of the economy** of any country. Moreover, they create significantly more employment than larger companies, train more people, and provide economic stability even during an economic crisis. SMEs are therefore also essential for a sustainable economy. However, their share of public contracts is often deemed insufficient.

**Legislative techniques** directed at increasing the participation of SMEs in public procurement include: the division of larger contracts into smaller lots, the reduction of ‘red tape’ bureaucratic hurdles, the limitation of participation requirements, requirements regarding the supply chain — such as direct payments to subcontractors, and reserving contracts to SMEs. This paper discusses one of these techniques: the division of contracts into lots.

Neither the **2011 UNCITRAL Model Law on Procurement** nor the techniques to favour SMEs covered in the Guide to Enactment (at 5-6) provide for the division into lots. In many countries, it is not practiced. This is also because the division into lots may have disadvantages. It might undermine the effectiveness of procurement when it is not technically or economically feasible, when the number or size of the lots is not geared towards the market in which they are to generate competition, or when the different components of a contract are highly dependent on each other and there is a need to coordinate them. Awarding a larger contract lowers administrative costs and increases buying power and economies of scale.

However, it is **argued** that the UNCITRAL Model Law on Procurement (with a basic provision) and Guide to Enactment (setting out details) should provide for the division into lots to increase SME participation in public procurement, based on the EU model. While the previous Directive 2014/18/EC merely tolerated the technique, **Article 46(1) of the new EU Public Sector Directive 2014/24/EU** now expressly and specifically provides that contracting authorities may award contracts divided into separate lots while they are free to determine the size and subject-matter of such lots. According to Article 46(4) Directive 2014/24/EU, EU Member States may also *require* rather than just allow the division into separate lots in their national laws transposing the Directive. Therefore, France and Germany could continue their already long-standing regimes of compulsory division into lots. However, in cases in which this has not been made obligatory by the transposing national law, such as in the UK or Austria, contracting authorities shall indicate the main reasons for their decision *not* to divide into lots. This means that, while the default approach suggested by the Directive is the division into lots and Member States have the option to make this obligatory for all or parts of the contracts subject to the Directive and their transposing national laws, the new Directive does not require the division into lots, as the decision not to divide a contract into lots merely requires a communication of the reasons, the “divide or explain principle”. If the contract is divided, bids for multiple lots are allowed to keep large companies interested while encouraging SME participation.

First, **economic theory** supports the division into lots. Public contracts can be complex and of substantial size and value, requiring considerable financial resources and technical expertise. SMEs will often be excluded from these contracts simply because they lack the capacity to manage such a large contract in its entirety. Therefore, there is some indication that a division of large public contracts into smaller lots — geographical lots, and/or technical lots — would extend the supplier and provider base beyond large companies to SMEs. This could increase competition and value for money, provided the division has no parallel negative effects on competition, especially due to collusion. However, there is yet no conclusive empirical evidence that division into lots increases SME participation.

Second, the division into lots is **preferable compared to most other techniques to increase SME participation**. Techniques that aim to promote SMEs as subcontractors by intervening in the supply chain



are too intrusive. This could undermine competition by discouraging the large companies acting as prime contractors from bidding for public contracts, and might even be the case for the requirement of direct payments to subcontractors. Cutting red tape, for example through the new European Single Procurement Document, may help SMEs, as it also helps large companies, but will not be sufficient on its own to increase SME participation. The reduction of participation requirements, such as minimum turnover — for example twice the turnover of the contract value — may increase SME participation but may compromise the interests of contracting entities in capable economic operators. Margins of preference for SMEs, for example allowing the most competitive SME to be x% more expensive than the most competitive large company, compromise competition and violate international trade principles. This is even more so when certain categories of contracts are completely reserved to SMEs. Finally, not including any technique to promote SME participation might permanently compromise competition and efficiency as SMEs continue not to bid for public contracts.

Finally, the division of larger contracts into smaller lots is **politically attractive**. While not violating obligations under international trade agreements, politicians and lawmakers of any political persuasion can do something for SMEs. This is important because these SMEs are or employ their voters. The UNCITRAL Model Law on Procurement should introduce the outlined flexible EU approach to the division into lots.

## *Dutch PPP tendering infrastructure into the equation*

*Marcelle van Valkenburg and Marijke Nagelkerke, Ministry of Infrastructure and the Environment, The Netherlands*

### *1. Introduction*

The member states of the EU countries have incorporated the EU Directive on public procurement 2014/24/EU<sup>1</sup> (hereinafter: EU Procurement Directive) in their national tender laws. In the Netherlands, tendering PPP infrastructure projects is currently based on tendering DBFM-contracts with the use of the competitive dialogue<sup>2</sup>. The aim of PPP contracts is to achieve value for money, which so far seems to be mostly accomplished in the Netherlands<sup>3</sup>. Other EU countries use the competitive dialogue<sup>4</sup> for tendering PPP contracts as well, while some EU countries<sup>5</sup> also use the ‘competitive procedure with negotiation’<sup>6</sup>. Although there are some differences, these two procedures are largely the same<sup>7</sup>. For the sake of limiting this paper however, the scope of this paper will be restricted to the competitive dialogue.

Companies participating in PPP tenders throughout Europe, are familiar with the EU Procurement Directive and the competitive dialogue. Next to the EU Procurement Directives other international tender regulations exist. One being the UNCITRAL Model Law on Public Procurement, with the purpose of progressive harmonization and modernization of international trade, which Model Law is an important international benchmark in procurement law reform<sup>8</sup>. As PPP is used worldwide it would obviously enhance inclusive competitiveness if applicable procurement regulations could be uniform worldwide. It is therefore interesting to compare the differences between these regulations to see if they may be further harmonised and modernised by profiting from each other’s drafts. The ‘request to proposals with dialogue’ procedure, as regulated in the UNCITRAL Model Law on Public Procurement, is largely comparable to the (EU) competitive dialogue.

The defining question of this paper therefore is **“how does the procedure ‘request for proposals with dialogue’ compare with the competitive dialogue and what can be learned from this comparison towards inclusive competitiveness by harmonising and modernising tender law applicable for PPP?”**

The findings in this paper have been based on literature research, evaluations on the application of the competitive dialogue and long-term experience in tendering PPP projects and PPP policy of both authors.

Firstly in this paper the current Dutch tendering practice of PPP infrastructure projects are explained. Secondly the applicable provisions regarding the ‘request to proposals with dialogue’ in the UNCITRAL Model Law on Public Procurement are compared to the competitive dialogue on the subjects of grounds for use, award criteria, the procedure requirements and confidentiality. These subjects have been chosen because they comprise the core elements of the tender procedures to be compared. Finally conclusions will be drawn, including some advice for adaption of both regulations.

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<sup>1</sup> Next to EU Directive 2014/24/EU (*Public Procurement*) also EU Directive 2014/23/EU (*Concession Contracts*) and 2014/25/EU (*Special Sectors*).

<sup>2</sup> Incorporated in the Dutch Procurement Act 2012 (in Dutch: Aanbestedingswet 2012)

<sup>3</sup> Paragraph 1.3 Progress Report DBFM(O) 2016-2017 (in Dutch: Voortgangsrapportage DBFM(O) 2016-2017) reports a financial value for money of 10-15%, which is up to 2016 € 1,5 billion of approximately € 13 billion.

<sup>4</sup> For example the UK, France, Belgium, Denmark and Sweden.

<sup>5</sup> For example Germany.

<sup>6</sup> Article 29 EU Procurement Directive.

<sup>7</sup> An essential difference is that in the ‘competitive procedure with negotiation’ candidates have to submit an initial tender which shall be the basis for the subsequent negotiations, article 29, paragraph 2 and 3 EU Procurement Directive.

<sup>8</sup> *UNCITRAL Model Law on Public Procurement*, United Nations Commission on International Trade Law, United Nations, New York, January 2014, page 1.

## 2. *Current tendering practice in Dutch PPP projects*

### 2.1 *Introduction*

In the Netherlands, the Ministry of Infrastructure and the Environment is, i.a. responsible for the national highway and waterway network. The Department of Public Works and Water Management (in Dutch: Rijkswaterstaat), is this Ministry's procurement agency and is i.a. responsible for the development and maintenance of the national road infrastructure network.

Since approximately 10 years PPP is one of the approaches of the Dutch government for public procurement of large infrastructure and housing projects. For these PPP projects DBFM(O) contracts are often used. The government has implemented PPP-contracts with the presupposition that it would be able to complete large infrastructure projects faster and more efficiently — i.a. through life cycle costing — with the use of PPP<sup>9</sup>. For a proper use of the private sector's contribution and to achieve the desired results the following principles were formulated:

- (1) formulating output based (functional) description of the contracting authority's requirements;
- (2) using an integral life cycle approach to procurement and project realisation, thus combining the consecutive stages (design, build and maintenance), corresponding disciplines (like obtaining permits, coordinating relocation of cables and pipelines, stakeholder management, IT etc.) and an integral project scope (e.g. an integral scope like a road corridor and total housing concept);
- (3) optimising or broadening the project scope and contract duration in order to obtain value for money;
- (4) transferring risks to the party best able to control them;
- (5) payment based on performance instead of products delivered;
- (6) integrating finance into the contract resulting in an actual transfer of risks for an optimal incentive for the private sector to control and reduce risks;
- (7) realising mutual cooperation;
- (8) tendering based on price/quality ratio.

### 2.2 *Why the competitive dialogue*

Rijkswaterstaat procures PPP infrastructure projects through the use of the competitive dialogue<sup>10</sup>. In the competitive dialogue any economic operator may submit a request to participate in response to a notification of tender. After pre-selection, the procuring authority will establish a dialogue with the candidates selected, with the aim to identify and define the means best suited to satisfy its needs. The procuring authority may limit the number of suitable candidates. The candidates selected are invited to the dialogue. After the dialogue stage candidates will be invited to submit their best and final offer<sup>11</sup>.

Since before 2004 the procurement strategy of Rijkswaterstaat has been subject to substantial changes. Where it used to be a large somewhat unwieldy and bureaucratic organization, aimed at tendering bills of quantity or contracts with detailed specifications and making its own designs, Rijkswaterstaat was required to make a substantial change in its performance, size and structure. The government required Rijkswaterstaat to become cheaper, smaller and more agile and to transfer more work to the private sector. In order to change its structure and performance the policy of Rijkswaterstaat focussed on involving the market in an early stage of the project development, based on contracts with functional specifications. It was expected that through the use of functional specifications in PPP- and D&C-contracts and an early involvement of the private sector the innovative capacity and expert knowledge on e.g. contract realisation and -exploitation could be utilised. The principle of approaching the private sector without a clear-cut

<sup>9</sup> "Final report of the project More Value through Mutual Cooperation (Meer Waarde door Samen Werken)". (1998) Dutch government report.

<sup>10</sup> Dutch Procurement Act 2012 (in Dutch: Aanbestedingswet 2012).

<sup>11</sup> Article 1.1 Aanbestedingswet 2012, definition 'competitive dialogue'.

solution incorporated in the contract however necessitates a more tailored tender approach, for which the competitive dialogue in particular was seen as the most suitable method.

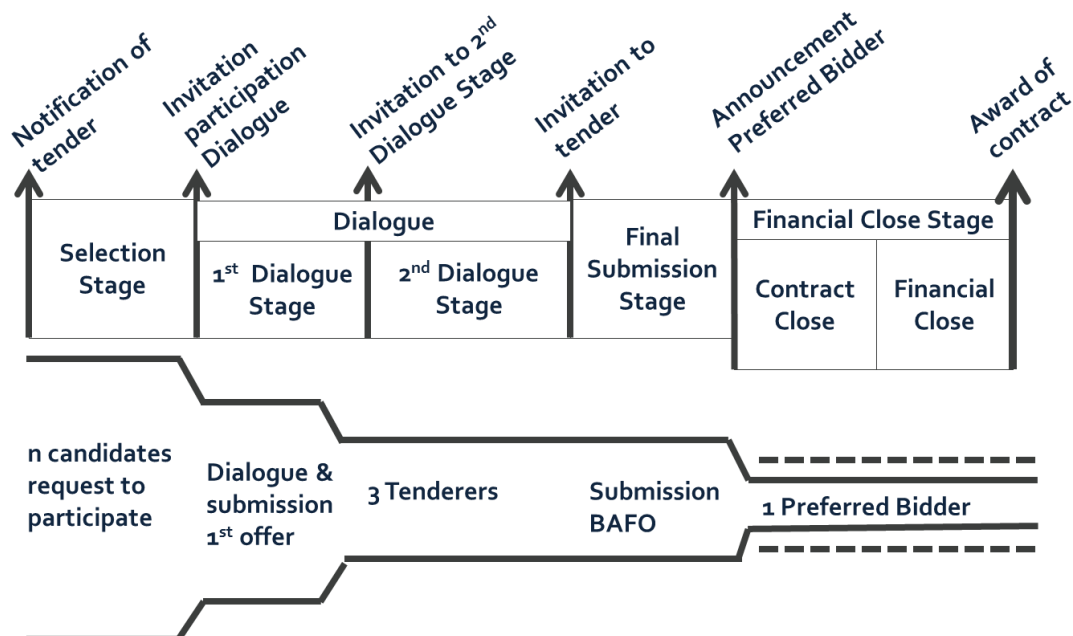
The fact that the market is approached without a clear-cut solution in mind in order to invite the private sector to devise new and smarter solutions fits the grounds for use of the competitive dialogue<sup>12</sup>. Use of the competitive dialogue by Rijkswaterstaat is based more specifically on the following criteria:

- (1) the requirements of the contracting authority cannot be met without adaptation of readily available solutions;
- (2) they include design or innovative solutions;
- (3) the contract cannot be awarded without prior negotiations; and
- (4) the technical specifications cannot be established with sufficient precision.

### 2.3 Overview tender process

At Rijkswaterstaat the competitive dialogue has been elaborated and optimised over the last 10 years in a 'standardised' framework procedure the size of which has been limited by stating applicability of the Dutch legislation on procurement and its guidelines, more specifically the guideline on the General Procurement Regulations for Works 2016 (Dutch abbreviation: ARW 2016). This framework has been laid down in its procurement policy for DBFM infrastructure projects, while the use of the ARW 2016 is obligatory for all government procurement authorities through the Dutch Procurement Act. The added bonus of this regular use of the ARW 2016 is that parties involved in government tenders are fully conversed on its contents, which saves time and money as the need for (legal) scrutiny of these rules is reduced.

The competitive dialogue takes place in successive stages in order to reduce the number of solutions to be discussed during the dialogue stage, as the candidates are requested to specify their proposals in the form of progressively refined proposals, as explained in the picture below.



The Competitive Dialogue Process

<sup>12</sup> Article 26 EU Procurement Directive.

## *Industry Day*

Before notification of tender the procuring authority organizes a so called Industry Day to generate interest for the tender and to inform possibly interested parties of the PPP project's scope, targets, procurement aims, etc.

## *Selection stage*

After its notification the tender commences with the selection stage during which candidates can qualify for participation in the first stage of the dialogue. Tendering Instructions are digitally provided to interested parties. These Tendering Instructions regulate the selection and the following stages of the tender procedure. Admission to the first stage of the dialogue is based on an assessment of the grounds of exclusion and suitability requirements. These suitability requirements, aimed at ensuring sufficient competition, mostly concern:

- economic and financial standing;
- project management experience;
- project financing experience.

The procuring authority invites the candidates in respect of whom no grounds of exclusion apply and who meet the suitability requirements to participate in the dialogue. These candidates receive in addition to the digital Tendering Instructions the concept contract documents and are given access to a virtual "Data Room" on an extranet site with information about the project.

## *Dialogue stage*

The dialogue is organized in two successive stages: the first and second dialogue stage.

In the event that more than three candidates satisfy the minimum conditions in the selection stage, the number of candidates are reduced to three by way of assessing their shortlisting products in the first dialogue stage. During the first dialogues with the procuring authority, the candidates are informed about the tender documents in general. The focus of the first dialogue stage is the project as such and the candidates' shortlisting products which must be submitted at the end of this stage. The shortlisting products usually exist of a risk management plan in which candidates formulate measures to mitigate the risks as specified by the procuring authority and elaborate upon what in their opinion could be good (innovative) opportunities for the project. The procuring authority invites the three candidates with the highest assessment scores for their shortlisting products to participate in the second dialogue stage.

During the second stage of the dialogue, the procuring authority completes the content of the DBFM contract in more detail in consultation with the candidates. During the dialogue the candidates can discuss the admissibility of certain proposals, as well as possible modifications of the DBFM contract<sup>13</sup>. The candidates may submit parts of their offer as a draft for discussion purposes. The objective of the second stage of the dialogue is to:

- discuss the principles of the DBFM contract and the final invitation to tender;
- give the candidates the opportunity to discuss parts of their draft offer;
- complete the DBFM contract;
- discuss the process to obtain project finance.

During this stage, no further shortlisting takes place. On the basis of the results of the dialogue, the procuring authority may revise the tender documents identically for all candidates. The procuring authority sets out the result of the dialogue in writing in a dialogue report.

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<sup>13</sup> Possible modifications are limited as substantial modifications are not allowed after the start of the tender.

## *Tender submission stage*

After conclusion of the second dialogue stage, the procuring authority invites the candidates to submit their best and final offers. The objective of this stage is to identify the preferred bidder. The award of the project takes place based on the criterion of the most economically advantageous tender (MEAT). The award criteria are tailor-made for each PPP infrastructure project. In general the criteria concern sustainability, stakeholder management, limiting construction/traffic nuisance and risk management.

### *3. UNCITRAL Model Law on Public Procurement versus EU Procurement Directive*

#### *3.1 Introduction*

Both the UNCITRAL Model Law on Public Procurement and the EU Procurement Directive provide (model) tender law for countries to include in their national legislation. Although the procedure ‘request for proposals with dialogue’ corresponds with the competitive dialogue and both tender procedures aim at achieving similar objectives, the actual texts and content of specific provisions differ. The UNCITRAL procedures ‘Request for proposals with consecutive negotiations’ and ‘Competitive negotiations’<sup>14</sup> also show similarities with the competitive dialogue. The comparison in this paper is however limited to the procedure ‘request for proposals with dialogue’ based on the fact that the ‘request for proposals with consecutive negotiations’ is limited to negotiations on price only, while the procedure on ‘competitive negotiations’ can only be used in cases of urgent need by the procurement authority<sup>15</sup>. As a result authors consider that there is a higher degree of compatibility of the procedure ‘request for proposals with dialogue’ with the competitive dialogue compared to the other two.

In this chapter the following subjects — which comprise the core elements of these tender procedures — are compared with regard to PPP:

1. the grounds for use of the procedure ‘request for proposals with dialogue’ versus the competitive dialogue;
2. requirements for the procedure ‘request for proposals with dialogue’ versus the competitive dialogue;
3. award criteria;
4. confidentiality.

Based on this comparison, some advice is formulated for adaption of both regulations to increase inclusive competitiveness by harmonising and modernising tender law.

#### *3.2 Grounds for use of the procedure ‘request for proposals with dialogue’ versus the competitive dialogue*

The grounds for use of the procedure ‘request for proposals with dialogue’ are provided in article 30, paragraph 2 (*Conditions for the use of methods of procurement [...] requests for proposals with dialogue [...]*) of the UNCITRAL Model Law on Public Procurement and the grounds for use of the competitive dialogue are stipulated in article 26 (*Choice of procedures*) of the EU Procurement Directive.

The provision regarding the grounds for use of the procedure ‘request for proposals with dialogue’ is to some extent similar to the grounds for use of the competitive dialogue as it stipulates the following conditions for use:

- (1) where it is not feasible for the procuring entity to formulate a detailed description of the subject matter of the procurement and the procuring entity assesses that dialogue with suppliers or contractors is needed to obtain the most satisfactory solution to its procurement needs;

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<sup>14</sup> Articles 50 and 51 UNCITRAL Model Law on Public Procurement.

<sup>15</sup> Article 30, paragraph 4 UNCITRAL Model Law on Public Procurement.

- (2) where the procuring entity seeks to enter into a contract for the purpose of research, experiment, study or development, except where the contract includes the production of items in quantities sufficient to establish their commercial viability or to recover research and development costs; and
- (3) where the procuring entity determines that the selected method is the most appropriate method of procurement for the protection of essential security interests of the State; or
- (4) open tendering was engaged in but no tenders were presented or the procurement was cancelled and engaging in new open-tendering proceedings would probably not result in a procurement contract.

The grounds for use of both tender procedures allow the procuring authorities to use these procedures for PPP projects, for which the market is approached without a clear-cut solution in mind in order to invite the private sector to devise new and innovative solutions.

With regard to the grounds for use the UNCITRAL Model Law on Public Procurement offers the possibility to apply the procedure ‘request for the proposals with dialogue’ for research objectives, be it with substantial restrictions on the scope of these research contracts<sup>16</sup>. The EU Procurement Directive has introduced the so called Innovation Partnership for research objectives<sup>17</sup>. On the one hand the possible scope for research contracts can be substantially extended in comparison to the stipulations in the UNCITRAL Model Law on Public Procurement, as the restrictions on establishing commercial viability and recovering research and development costs no longer apply in the EU setting<sup>18</sup>. On the other hand however the procedure applicable to Innovation Partnership is compared to the competitive dialogue less open to dialogue on possible solutions offered by the private sector as the basis of the tender for an Innovation Partnership is based on the ‘competitive procedure with negotiation’, which requires an initial tender which will be subject to negotiations<sup>19</sup>. In order to be able to submit a viable tender the information provided by the procuring authority to the participants needs to be sufficiently precise<sup>20</sup>, which precision in itself limits the possible solutions — some of which may not be known to the procuring authority— offered by the private sector.

In view of the developments within the EU Procurement Directive one could consider removing the current restrictions on the contract scope for research objectives for the UNCITRAL Model Law on Public Procurement. On the flip side, the EU Procurement Directive could leave more room for determining the possible innovative solutions available by incorporating more aspects of the competitive dialogue instead of the ‘competitive procedure with negotiation’<sup>21</sup>.

### 3.3 Requirements for the procedure ‘request for proposals with dialogue’ versus the competitive dialogue

The requirements regarding the procedure ‘request for proposals with dialogue’ are elaborated in article 49 (*Request for proposals with dialogue*) of the UNCITRAL Model Law on Public Procurement and the requirements for the competitive dialogue are elaborated in article 30 (*Competitive dialogue*) of the EU Procurement Directive.

The first issue that comes to mind while comparing both articles is that the EU Procurement Directive provision is much more concise. The UNCITRAL Model Law on Public Procurement contains some overly detailed provisions, together with the use of some obscure language, which makes it less easy to understand.

<sup>16</sup> Article 30, paragraph 2 UNCITRAL Model Law on Public Procurement.

<sup>17</sup> Article 31 EU Procurement Directive.

<sup>18</sup> Article 31 EU Procurement Directive.

<sup>19</sup> Article 31, paragraph 3 EU Procurement Directive.

<sup>20</sup> Article 31, paragraph 1 EU Procurement Directive.

<sup>21</sup> Article 29 EU Procurement Directive.

The EU Procurement Directive in comparison is more to the point. Whether or not the level of detail is necessary for provisions in law may be held to scrutiny. Some examples:

- the detailed instructions to be included in the invitation (paragraph 2) compared to paragraph 2 of the EU Procurement Directive, which is more concise;
- the pre-qualification proceedings (paragraph 3) compared to paragraph 1, third and fourth sentences, of the EU Procurement Directive, which is more concise;
- the detailed instructions to be included in the requests for proposal (paragraph 5).

In the Netherlands the EU Procurement Directives are incorporated in Dutch Procurement Act while more detailed instructions — like e.g. the detailed instructions to be included in the tender documents, invitation and requests for proposal — are incorporated in general procurement regulations for tenders, such as the ARW 2016<sup>22</sup>. It is therefore possible to remove these detailed instructions from article 49 of the UNCITRAL Model Law on Public Procurement and incorporate these instructions into either separate general regulations or a legislative guide.

The EU Procurement Directive requires the procuring authority to set out its needs and requirements, award criteria and indicative timeframe, in either the contract notice or descriptive document<sup>23</sup>. Therefore, in the tender practice of Rijkswaterstaat, Tendering Instructions including the legal, organizational and procedural information necessary for the tenderers to participate in the tender, are issued to the candidates upon their request as from the notification of tender. Within EU procurement it is deemed more transparent to provide information about the tender procedure — e.g. the award criteria, whether or not the subject matter is divided in portions, the currency for the proposal price, the number of candidates to be selected — at the very start of the tender. Article 49 of the UNCITRAL Model Law on Public Procurement requires the procuring authorities to limit inclusion of this kind of information in the request for proposals, so after the pre-qualification<sup>24</sup>. For transparency purposes this article could be adapted in accordance with the transparency requirements from the EU Procurement Directive.

The procedure ‘request for proposal with dialogue’ is required to start with a request for proposals after pre-selection<sup>25</sup>. In lieu of the room for dialogue as stipulated in the EU Procurement Directive<sup>26</sup> there seems to be no opportunity for a dialogue between the procuring authority and the pre-selected candidates before the (first) proposals have to be submitted.

Furthermore the procedure ‘request for proposal with dialogue’ is based on a more traditional approach of pre-selecting participants on the basis of their qualifications only (e.g. based on the level of past experience). This may have as a consequence that new companies and companies which would like to expand onto a new field of expertise do not really stand a chance to compete with large and or experienced companies, while these companies might have certain innovations to offer. By using the opportunity offered by the competitive dialogue to reduce the number of solutions in successive stages<sup>27</sup> parties are selected because of submitting the best solutions irrespective of the length of their experience in a specific field.

Lack of dialogue before the initial proposal may also mean that there is no opportunity to explain and discuss the needs and requirements of the procuring authority. This may leave room for misunderstandings. The procuring authority must have a clear view of its needs and requirements from the start, resulting in less room for approaching the private sector without a clear-cut solution incorporated in the contract. Some

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<sup>22</sup> General Procurement Regulations for Works 2016 (in Dutch: Aanbestedingsreglement Werken 2016 (ARW 2016)).

<sup>23</sup> Article 30, paragraph 2 EU Procurement Directive.

<sup>24</sup> Article 49, paragraph 5 UNCITRAL Model Law on Public Procurement.

<sup>25</sup> Article 49, paragraph 4 until 7 UNCITRAL Model Law on Public Procurement.

<sup>26</sup> Article 30, paragraph 4 EU Procurement Directive.

<sup>27</sup> Article 30, paragraph 4 EU Procurement Directive, states: competitive dialogues may take place in successive stages in order to reduce the number of solutions to be discussed during the dialogue stage by applying the award criteria laid down in the contract notice or in the descriptive document.



smart and/or innovative solutions may not completely fit within the initial requirements despite being attractive for the procuring authority. As there is no room for dialogue, the procuring authority will not know how to adapt unintentionally restrictive requirements. These limitations do not seem to be consistent with the following grounds for use of the procedure ‘request for proposals with dialogue’:

(a) “it is not feasible for the procuring entity to formulate a detailed description of the subject matter of the procurement [...], and the procuring entity assesses that dialogue with suppliers or contractors is needed to obtain the most satisfactory solution to its procurement needs;

(b) the procuring entity seeks to enter into a contract for the purpose of research, experiment, study or development, except where the contract includes the production of items in quantities sufficient to establish their commercial viability or to recover research and development costs”<sup>28</sup>.

The requirement to start with a request for proposals after the pre-selection is comparable to the requirement regarding the ‘competitive procedure with negotiation’<sup>29</sup>, where it is stipulated that candidates have to submit an initial tender which shall be the basis for the subsequent negotiations<sup>30</sup>. However, the ‘competitive procedure with negotiation’ is meant to be used for less innovative, more clear-cut projects in a mature market.

In order to solve the above mentioned inconsistencies it could be considered to adapt the provisions in the UNCITRAL Model Law on Public Procurement to allow the dialogue stage to take place in successive stages in order to reduce the number of solutions and or candidates to be discussed during the dialogue stage by applying the award criteria in accordance with article 30 of the EU Procurement Directive.

The UNCITRAL Model Law on Public Procurement requires that the “*dialogue shall be conducted by the same representatives of the procuring entity on a concurrent basis*”<sup>31</sup>. This seems to aim at maintaining a consistent make-up of the dialogue team of the procuring authority during the dialogue and by extension of the dialogue itself. This requirement however may also be unnecessarily restrictive. This kind of consistency is difficult to uphold as employees and consultants may change jobs, get ill or leave the dialogue team for other reasons. There are other measures to ensure consistency in the dialogue. In the Netherlands for example the procuring authority makes sure that the key players in the tender and dialogue team have deputies, which can step in if necessary. Consistency may also be upheld by allowing informal, specialist dialogue meetings - in which specific technical, legal, financial, or other subjects regarding the contract can informally be discussed between specialists of the candidates and the procuring authority - while only issues decided upon by the dialogue team can be legally binding. The details of these organizational measures are not provided for in the EU Procurement Directive. As long as the principles of the EU Procurement Directive are upheld procuring authorities have freedom to establish their own tender organizations. With this in mind, the UNCITRAL paragraph seems too restrictive and could in our opinion be removed.

The procedure ‘request for proposals with dialogue’ should include “*any element of the description of the subject matter of the procurement or term or condition of the procurement contract that will not be the subject of dialogue during the procedure*”<sup>32</sup>. Moreover it is not allowed to “*modify the subject matter of the procurement*” or “*any element of the description of the subject matter of the procurement or any term or condition of the procurement contract that is not subject to the dialogue as specified in the request for proposals*”<sup>33</sup>. These requirements seem to aim at restricting the dialogue, in order to make sure that no substantial modifications of the contract will take place. However these requirements may be unnecessarily restrictive. Despite a thorough preparation of the tender it may not be foreseeable that some elements need to be subject of dialogue after all, e.g. for clarification purposes. This is inherent to the principle of

<sup>28</sup> Article 30, paragraph 2 sub (a) UNCITRAL Model Law on Public Procurement.

<sup>29</sup> Article 29 EU Procurement Directive.

<sup>30</sup> Article 29, paragraph 2 and 3 EU Procurement Directive.

<sup>31</sup> Article 49, paragraph 8 UNCITRAL Model Law on Public Procurement.

<sup>32</sup> Article 49, paragraph 5 sub (f) UNCITRAL Model Law on Public Procurement.

<sup>33</sup> Article 49, paragraph 9 UNCITRAL Model Law on Public Procurement.

approaching the private sector without a clear-cut solution incorporated in the contract to give room to innovative solutions of the market parties, of which the procuring authority is as yet unaware. In comparison, the EU “substantial modification” doctrine<sup>34</sup>, which is based on long term EU jurisprudence and allows modifications to a certain extent, is a sound framework for how this doctrine could be included in the UNCITRAL Model Law on Public Procurement.

Furthermore paragraph 12 of article 49 of the UNCITRAL Model Law on Public Procurement seems too restrictive for complex contracts, especially when the tender is based on involving the market in an early stage of determining the procurement authority’s needs and requirements, without the aforementioned clear-cut solution. Why should the procuring entity not be able to negotiate any changes, clarifications or refinements at all in the final offer? Of course the room for manoeuvre that procuring authorities have after the submission of a final offer is fairly limited. Fundamental changes cannot be made, but in (complex) procurement — like PPP — there should be room for some final adjustments to tenders (fine-tuning). The EU Procurement Directive allows adjustments to final tenders after the dialogue stage has been concluded, provided the essential aspects of the tender are not changed and that the adjustments are not likely to distort competition or have a discriminatory effect<sup>35</sup>. The argument that there already has been an entire dialogue stage prior to the tenders in which (preliminary) offers can be fully synchronized to the requirements fails to observe the economical facts. Considering the complexity of the tenders, the available time in the tender procedure and the need to limit transaction costs it is highly unlikely that tenders are fully elaborated and discussed during the dialogue. On top of that participants will want to further optimise their solutions. The procuring authority may also want to partly fine-tune its output specifications on the basis of progressive understanding. It could be considered to adapt the UNCITRAL Model Law on Public Procurement in similar fashion to allow adjustments to final tenders after the dialogue stage has been concluded, provided that the essential aspects of the tender are not changed and that the adjustments are not likely to distort competition or have a discriminatory effect.

### 3.4 Award Criteria

The award criteria for tenders are elaborated in article 11 of the UNCITRAL Model Law on Public Procurement and article 67 of the EU Procurement Directive.

Both regulations give room for tailor made elaboration of award criteria relating to either just price or (life cycle) costs or the best price-quality ratio, which is called the most economically advantageous tender (MEAT) in the EU Procurement Directive. Both regulations give examples of possible award criteria and require that the criteria are linked to the subject matter of the contract. However, the examples given in the EU Procurement Directive are somewhat broader than the examples given in the UNCITRAL Model Law on Public Procurement, for example those with regard to the “social aspects” and “quality”.

On the other hand however, the UNCITRAL Model Law on Public Procurement leaves more room for listing all evaluation criteria in descending order of importance, instead of specifying the relative weights of the criteria. In comparison the EU Procurement Directive only allows this if weighting is not possible for objective reasons. For simplification’s sake it could seem attractive to adapt the EU Procurement Directive in order to suffice with listing the evaluation criteria in descending order of importance. Whether this would lead to improved tender results however is up for debate. Before deciding on such a simplification it would therefore be advisable to research the tender results from the use of both methods.

The UNCITRAL Model Law on Public Procurement provides a practical guideline with “*to the extent practicable, all non-price evaluation criteria shall be objective, quantifiable and expressed in monetary terms*”<sup>36</sup>. This guideline could be a very useful tool for the EU Procurement Directive as well.

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<sup>34</sup> Article 72, paragraph 4 sub (a) EU Procurement Directive.

<sup>35</sup> Article 30, paragraph 6 EU Procurement Directive.

<sup>36</sup> Article 11, paragraph 4 UNCITRAL Model Law on Public Procurement.

The UNCITRAL Model Law on Public Procurement allows the procuring authority “*a margin of preference for the benefit of domestic suppliers or contractors or for domestically produced goods, or any other preference, if authorized or required by the procurement regulations or other provisions of law of this State*”<sup>37</sup>. This preferential treatment for domestic suppliers or contractors is not allowed according to the stipulations of the EU Procurement Directive, because it is deemed to conflict with the non-discriminatory principle. The non-discriminatory principle is firmly based on the EU Treaty, which has realising an open internal EU-market as one of its founding principles<sup>38</sup>. Furthermore it is unclear in the UNCITRAL Model Law on Public Procurement which procurement regulations are meant with the provision stating “*the margin of preference shall be calculated in accordance with the procurement regulations*”. As preferential treatment of domestic suppliers or contractors is an anathema to one of the founding principles of the Treaty on the EU and the Treaty on the Functioning of the EU, for harmonisation purposes it could be considered to remove said provision in the UNCITRAL Model Law on Public Procurement.

### 3.5 Confidentiality

Confidentiality of information communicated by candidates who participate in a tender is elaborated in article 24 of the UNCITRAL Model Law on Public Procurement and articles 21 and article 30, paragraph 3, of the EU Procurement Directive.

Both regulations provide which information supplied by the candidates participating in a tender, and more specifically, during the dialogues, has to be considered confidential. However, the UNCITRAL Model Law on Public Procurement seems unnecessary restrictive, as it states: “*Any discussions, communications, negotiations or dialogue between the procuring entity and a supplier or contractor [...] shall be confidential. Unless required by law or ordered by the [name of the court or courts] or the [name of the relevant organ designated by the enacting State], no party to any such discussions, communications, negotiations or dialogue shall disclose to any other person any technical, price or other information relating to these discussions, communications, negotiations or dialogue without the consent of the other party*”<sup>39</sup>. While it makes sense to make an exception when disclosure of information is required by national law or court, it seems too restricting to order all communication during the dialogues as confidential. Namely, it is possible that subjects discussed during the dialogue are not confidential. Some information the procuring authority may even be obliged to share with the other candidates, to ensure equality of treatment among all candidates. An example may be that information provided by one of the candidates concerns an error in the contract or tender document of which the procuring authority must inform the other candidates. Of course confidential information about the solutions planned or proposed by the candidate or other commercially sensitive information has to be kept confidential, but a general clause that all communication during the dialogue is confidential can be too restrictive. In this case the wording of the EU Procurement Directive seems more balanced: “*the contracting authority shall not disclose information forwarded to it by economic operators which they have designated as confidential, including, but not limited to, technical or trade secrets and the confidential aspects of tenders*”<sup>40</sup>. There is the possibility within the EU Procurement Directive to agree upon disclosure of confidential information, however this agreement may not take the form of a general waiver<sup>41</sup>. This means that information that is not confidential, like information that does not concern solutions, technical or trade secrets, confidential aspects of tenders or other confidential information, does not have to be kept confidential. In this light it could be considered to adapt the UNCITRAL provision accordingly.

<sup>37</sup> Article 11, paragraph 3 sub (b) UNCITRAL Model Law on Public Procurement.

<sup>38</sup> Article 3, paragraph 3 Treaty on the EU and article 18 Treaty on the Functioning of the EU.

<sup>39</sup> Article 24, paragraph 3 UNCITRAL Model Law on Public Procurement.

<sup>40</sup> Article 21, paragraph 1 EU Procurement Directive.

<sup>41</sup> Article 30, paragraph 3 EU Procurement Directive, states: contracting authorities shall not reveal to the other participants solutions proposed or other confidential information communicated by a candidate or tenderer participating in the dialogue without its agreement. Such agreement shall not take the form of a general waiver but shall be given with reference to the intended communication of specific information.

#### 4. Conclusions

In the Netherlands the national Procurement Act is based on the EU Procurement Directives<sup>42</sup>. The EU Procurement Directives correspond with the General Agreement on Tariffs and Trade (GATT) of the World Trade Organisation (WTO). The UNCITRAL Model Law on Public Procurement on the other hand does not completely correspond with both the EU Procurement Directives or the GATT. Use of language, definitions, (names of) tender procedures, etc. are different. However, although the distinctive regulations have similar objectives aimed at achieving fair competition, transparency and equality, legislative harmonisation is not complete. We therefore advise to update the Model Law and align it with both the EU Procurement Directives and the GATT. Updating the Model Law could also be used to obtain a regulation more easily understood. In addition it could result in actual legislative harmonisation by a large part of the international community as the EU Procurement Directives are already in use and known to a large part of the private sector. Companies participating in PPP tenders throughout Europe, are familiar with the EU Procurement Directive and the competitive dialogue. As PPP is used worldwide it would obviously enhance inclusive competitiveness if procurement regulations could be uniform worldwide.

In the previous chapter several examples have been illustrated of specific provisions of the UNCITRAL Model Law on Public Procurement and the EU Procurement Directive which could be harmonised and even modernised. In our view, these examples show that both regulations can profit from each other's drafts. We therefore also advise to compare the remainder of the regulations of the UNCITRAL Model Law on Public Procurement with the EU Procurement Directives. The resulting harmonisation and modernisation could further enhance worldwide inclusive competitiveness in public procurement.

In order to obtain regulations more easily understood the more detailed instructions incorporated in the UNCITRAL Model Law on Public Procurement could be removed from the Model Law itself and included in general regulations and (legislative) guidelines for tenders, like this has been done in the Netherlands<sup>43</sup>. Uniform procurement regulations available for each tender procedure can also promote efficiency in preparing and conducting (individual) tenders as procurement agencies could suffice with simply declaring these regulations applicable to a specific tender procedure. Especially when these procurement regulations are drafted in a way so that they can be used irrespective of the applicable national laws, or with very little adjustments, it would make life a lot easier for many procurement authorities.

Finally, the UNCITRAL Model Law on Public Procurement uses somewhat obscure language which makes it difficult for people — not being proficient in English — to quickly and easily grasp the essence and finesse of the UNCITRAL Model Law on Public Procurement. This difficulty is somewhat less of a problem with the EU Procurement Directive. Should the UNCITRAL Model Law on Public Procurement be updated simplification of the language used should also be given attention.

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<sup>42</sup> EU Directive 2014/24/EU (*Public Procurement*) also EU Directive 2014/23/EU (*Concession Contracts*) and 2014/25/EU (*Special Sectors*).

<sup>43</sup> General Procurement Regulations for Works 2016 (in Dutch: Aanbestedingsreglement Werken 2016 (ARW 2016)).



